

Prison Industry Authority:

**Statutory and Cost Control Problems
Adversely Affect the State**

April 1996
95106

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April 9, 1996

The Governor of California
President pro Tempore of the Senate
Speaker of the Assembly
State Capitol
Sacramento, California 95814

Dear Governor and Legislative Leaders:

As requested by the Joint Legislative Audit Committee, the Bureau of State Audits presents its audit report concerning the Prison Industry Authority (PIA). This report was prepared under contract by Ernst & Young, LLP. The report concludes that contradictory enabling statutes and the PIA's inability to manage and control its costs adversely affect the State. Specifically, the report shows that the PIA managers have made different interpretations of the statutes over time resulting in a lack of clear and consistent long-term direction and mission. In addition, neither the PIA nor the California Department of Corrections (CDC) have empirically demonstrated the PIA's success at meeting its stated program purposes. The report also concludes that the Prison Industry Board does not effectively monitor the PIA's operations.

The report notes that the PIA's financial statements are properly audited in accordance with Generally Accepted Accounting Principles, and that these financial statements indicate that the PIA is "profitable." Nevertheless, the report concludes the PIA is not self-supporting because significant subsidies that the PIA receives are not reflected in its financial statements. These subsidies include low rent on CDC facilities, interest on money borrowed to purchase PIA plant and equipment which is paid by the General Fund, and inflated prices on the goods and services other state agencies are obligated to buy. The PIA's policy of setting prices, so as to subsidize ineffective factories, results in the true cost of this inmate work program being hidden in the budgets of other state agencies and policymakers being unable to review and debate the costs and benefits of this inmate work program.

Finally, the report concludes that the PIA does not have accurate product cost information and is unable to manage costs on a product basis. The PIA does not follow common industry practices for cost accounting and does not have sufficient cost accounting training or expertise for an organization of its size and complexity.

Respectfully submitted,



KURT R. SJOBERG
State Auditor

California

State Auditor

Bureau of State Audits

April 1996

**Prison Industry Authority:
Statutory and Cost
Control Problems
Adversely Affect the State**



State of California

(95106)

ERNST & YOUNG LLP

NewPoint Group, Inc.

April 5, 1996

Mr. Kurt R. Sjoberg
California State Auditor
Bureau of State Audits
660 J Street, Suite 300
Sacramento, California 95814

Dear Mr. Sjoberg:

Ernst & Young LLP is pleased to present our independent report on the Prison Industry Authority (PIA). As the largest state prison industry program in the United States, the PIA has many opportunities for demonstrating leadership and improving its operating, financial, and programmatic performance.

The PIA is at an important juncture in its evolution, and this report provides critical analysis needed to assess the future direction of the program. We hope the recommendations in this report are implemented to help improve benefits from the PIA program.

We would like to acknowledge the substantial help and guidance of Mr. Fred S.C. Forrer, Special Assistant State Auditor. Mr. Forrer was instrumental in helping to shape many of the key guiding principles from this report as well as assisting with the report's findings and recommendations.

This was a challenging project which was completed in a short, four-month time frame. We would like to thank our lead subcontractor, NewPoint Group, Inc. (Sacramento), who provided much of the management for this project.

The entire Ernst & Young project team appreciates the opportunity to be of service to the Bureau. Should you have any questions or comments concerning this report, please do not hesitate to contact me in Sacramento at (916) 449-3517.

Very truly yours,

ERNST & YOUNG LLP



Mark S. Nexsen
Partner

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Summary

Results In Brief

The Prison Industry Authority (PIA) was established thirteen years ago on January 1, 1983, as successor to the California Correctional Industries Commission. The PIA now operates 73 manufacturing, service, and agricultural facilities at 23 of the 30 California Department of Corrections (CDC) prisons. The PIA employs 7,012 inmates, or approximately six percent of the CDC institutional population. The 1,750 core products manufactured by the PIA are sold principally to departments of the State of California, who are required by law to purchase from the PIA. Sales in fiscal year 1994/95 were \$152 million for the PIA.

The PIA is a penal program which exists to employ inmates, develop inmate work-skills, and reduce CDC operations costs. Neither the PIA nor the CDC have empirically demonstrated the PIA's success in meeting its stated program purposes, with the sole exception of the number of inmates employed. Although the State has contributed \$109 million to the PIA for plant and equipment, there is no measurable evidence of the penal programmatic benefits to offset this investment.

Since fiscal year 1989/90, the number of inmates employed by the CDC has declined nine percent, while the number of state employees working for the PIA has declined three percent. The PIA is having a diminished impact on providing programming alternatives to the CDC's rapidly growing inmate population.

The PIA's enabling statutes are contradictory and PIA managers have interpreted statutes differently over time and often at the same time. The internal operating mission statement has often been redefined to meet changes in the PIA's legislative and economic operating environment. For example, the mission has been stated to be a profitable enterprise, to provide a maximum number of inmates with training and work experience, or to meet or surpass the expectations of PIA customers. The result is a lack of clear and consistent, long-term mission and direction.

The Prison Industry Board does not effectively monitor the PIA operations. It is not operating as an independent board nor providing sufficient input to PIA policy, or adequate budgetary oversight and review of the PIA.

The lack of clear management and policy authority and oversight can be demonstrated by the PIA's textile mill. After nearly 10 years, \$17 million, and considerable transformation, the textile mill at R. J. Donovan Correctional Facility has finally begun production. It employs 130 inmates, less than one-half the number originally planned. The State may never recover its

investment in the facility, and the plant is likely to continue to operate at a loss. Also, the mill may never be able to produce fabric at a cost below market prices for comparable fabric.

The PIA is not self-supporting and does not reduce the State's costs, both of which are stated purposes in PIA's enabling statutes. The PIA's policy of establishing prices above full costs in order to subsidize weaker operations directly impacts customers and ultimately taxpayers. As a result, state agencies purchasing products such as printing services, lens grinding, license plates, metal products, and fabrics, pay \$12 million more than the full cost of making these products. As a primary customer, the CDC paid \$6.9 million of these "profits," even though one of the PIA's statutory purposes is "reducing the cost of its (CDC's) operations." All these profits were used by the PIA to offset losses at less efficient factories.

The PIA's policy of setting prices so as to subsidize ineffective factories results in: (1) the true cost of inmate employment programs being hidden in the expenditures of other state agencies, (2) policy makers being unable to review and debate costs and benefits of this inmate work program, and (3) taxpayers losing the benefits of efficient PIA operations by paying more than the true cost of many PIA products. Also, based on competitive prices obtained by both the PIA and our own review team, if the PIA were required to compete with private sector suppliers for State contracts, they would not be competitive in a wide range of products.

Further, the PIA has numerous weaknesses and inefficiencies in its financial management of factory and product costs. It lacks critical cost accounting processes and tools and does not follow common industry practices in costing and accounting for product costs.

The PIA does not effectively plan or manage this complex, multi-industry business. Specifically, the PIA does not plan for its various functions, including strategic planning, production planning, order fulfillment, budget management, cost accounting, investment analysis, and cash management.

Specifically, the PIA:

- ☐ Maintains excess inventory levels, resulting in unnecessary carrying costs of approximately \$2.7 million in fiscal year 1994/95, and has underutilized warehouse space
- ☐ Has difficulty delivering its products, averaging approximately 150 days to deliver products, losing interest earnings of approximately \$600,000 each year due to billing and payment delays

-
- ❑ Recently embarked on an expensive change in production strategy. This shift from making products after a customer places an order (“make-to-order”) to making and building an inventory of products in advance of customer orders (“make-to-stock”), is an expensive solution to delivery problems. The annual excess cost of the first phase of this new program (which offers customers 38 products) is \$688,000. Improvements in sales forecasting, production planning, and product focus could reduce delivery times, but at lower costs to the State
 - ❑ Does not coordinate production planning to facilitate production and sales
 - ❑ Has too many products resulting in a diffusion of management responsibility and accountability, a shortage of managers with the necessary breadth of expertise, inconsistent and wide swings in the financial performance of each factory, and an inability to develop plans for expanding, reducing, or discontinuing products.

Customers are not satisfied with the PIA’s performance, and are particularly upset with long delivery times and higher prices. Of those who responded to our detailed questionnaire, 71 percent felt that the PIA was worse than other suppliers. However, customers are most satisfied with PIA’s customer service, in particular that the PIA processes waivers in a timely manner, makes it easy to place an order, provides clear invoices, treats them as an important customer, and resolves problems that occur. Also, responses with respect to quality of products and service were generally favorable, with 39 percent of respondents satisfied, and 23 percent dissatisfied. Three-fourths of the respondents indicated that quality remained the same over the last three years, while 23 percent indicated improvement.

During this performance audit, we noted a number of accomplishments and milestones attained by the PIA, demonstrating management and staffs’ dedication, hard work, and commitment to continuous improvement. We found that the PIA:

- ❑ Has significantly improved delivery times for 38 selected standard furniture products included in its “Prompt Delivery” program
- ❑ Operates successful optical labs. The rates charged for over 424,000 orders last fiscal year were below market and recovered the full operating and non-production costs of the labs. The State and taxpayers benefit from the savings, the CDC is able to provide inmate programming efficiently, and meaningful work experience as provided for over 300 inmates

-
- ☐ Compares favorably on a number of measures with correctional industries in Texas, Florida, New York, and the Federal government
 - ☐ Obtained four patents for Century 2000. Century 2000 is a line of modern modular panel office systems which the PIA custom-designs for customers
 - ☐ Is implementing a sophisticated manufacturing information system. Though considerable work remains in order for the PIA to effectively use this automated system, since its implementation, the PIA has reduced inventory levels, improved accuracy of inventory counts to 98 percent, and reduced the time it takes to process a customer's order.

Recommendations

The Legislature should clarify the statutes governing the PIA by, among other actions, eliminating the conflicting purposes in the current law and considering that PIA be required to price all of its products at cost and not selling any product at a price which is higher than the market price for a comparable product.

The Legislature should either make the PIA a division of the CDC or reform the Prison Industry Board (PIB). Specifically, the Legislature should consider the following alternatives:

- ☐ Eliminate the PIB and make the PIA a division of the CDC; or
- ☐ Make the PIA a division of the CDC and retain the PIB with certain limited responsibilities; or
- ☐ Retain the current organization structure of the PIA and reform the PIB to make it more effective.

Both the CDC and the PIA should develop the penal aspects of the PIA program. Specifically, both organizations should measure and report on the programmatic benefits of the PIA and evaluate the impact of PIA participation on inmates during their incarceration and after their release.

The PIA should establish policies and practices to ensure that cost efficiencies are passed on to state customers and that prices do not exceed market. For example, the PIA should strive to make all products self-supporting, assign responsibility for specific industries to specific individuals, manage and reduce its operating and administrative costs, and perform a comprehensive review of all industries to determine which ones should be expanded, scaled back, or eliminated.

The PIA should improve the management of its operations. We make a number of detailed recommendations including reducing the time to prepare financial management reports, improving the utilization of the manufacturing and accounting planning system, hiring experienced cost accountants, developing meaningful performance measures, improving sales and production forecasting and planning, improving inventory and warehouse management, and significantly reducing delivery times.

The CDC should improve its operations which impact the PIA such as projecting its need for PIA's goods and services throughout the year and coordinating periodic shipments.

Prison Industry Board and Prison Industry Authority Response

In their response, the Prison Industry Board and the PIA do not disagree with this report's findings regarding conflicting statutes. They also concur with many of the report's other findings, including the PIA's inability to manage costs and profitability of its products and factories. The board and the PIA also recognize that there is ample room for increased efficiencies and improvements in its operations, and they especially appreciated the specific report's operations recommendations.

The board and the PIA do disagree with several basic issues throughout the report. The board believes that the performance audit fails to establish consistent criteria against which to audit PIA performance, and that the report deviates from generally accepted accounting principles and nationwide standards for industry programs. The board and the PIA also believe that because the PIA operates in a government setting, it cannot operate in a totally businesslike manner and, therefore, should not be compared to private enterprises. The board takes exception to the report's findings related to the board, and is concerned that the report does not recognize the role of the PIA in successfully managing the state's prison population.

The PIA expresses concerns with two of the report's recommendations. The PIA believes it cannot be competitive if it is required to adopt a cost-of-service model, and states that the report provides no rationale to explain how the PIA's effectiveness would be enhanced by eliminating the board or making the PIA a Division of the CDC.



To provide clarity and perspective, we provide our comments to responses from the board and the PIA at the end of this report.

Introduction

The Prison Industry Authority (PIA) was established thirteen years ago on January 1, 1983, as the successor to the California Correctional Industries Commission. The PIA is managed under the policy direction of an eleven member Board of Directors. Three are ex-officio board members as a result of State positions, and eight are appointed by the Governor and the Legislature. The PIA is technically a part of the California Department of Corrections (CDC), although it does not submit a budget to the Department of Finance for approval. Approximately 773 full-time equivalent civilian state employees work for the PIA. Administrative offices of the PIA are located near Folsom, California.

The PIA is the largest state prison industry program in the United States in terms of sales. For fiscal year ending June 30, 1995, the PIA sold \$152 million of goods and services, the highest in its history.

The PIA manages 73 factories which produce approximately 1,750 core products and nearly 28,000 discrete products. The PIA employs approximately 7,012 inmates, or six percent of inmates housed by the CDC. The PIA operates facilities in 23 of the 30 CDC institutions.

Products manufactured by the PIA are sold principally to departments of the State of California. PIA products also can be sold to cities, counties, special districts, and public schools in California, as well as to: (1) public agencies in other states whose laws permit the purchasing, (2) federal agencies (subject to their own regulations), and (3) foreign governments and foreign businesses.

Exhibit 1, at the end of this section, shows how the Prison Industry Board (board) is organized, and **Exhibit 2** shows how the PIA is organized and staffed. **Exhibit 3** shows locations of the 23 CDC institutions where the PIA now operates at least one factory. **Exhibit 4** shows the 73 different factories, as organized by 31 industries at the 23 institutions. **Exhibit 5** provides a summary description of PIA products.

The California Department of Corrections

The CDC is responsible for the incarceration, training, education, and care of adult felons and nonfelon narcotic addicts. It also supervises and treats parolees released to the community. The CDC is the nation's largest prison system.

The CDC currently operates 30 institutions, plus a central medical facility and a treatment center for narcotic addicts under civil commitment. The CDC system also includes other reception centers, fire and conservation camps, and

correctional training center, as well as alternative sentencing programs and outpatient psychiatric services for parolees.

The CDC has a \$3.5 billion budget in fiscal year 1995/96. Two new prisons just opened (Lassen and Madera), and another two are expected to open in the near future. As a result of the tremendous growth expected in the inmate population, the CDC's general fund costs will continue to increase significantly through the end of this decade.

**There Are
Numerous
Competitive
Advantages and
Disadvantages of
the PIA**

The Legislature found that the prior California Correctional Industries Commission had "failed to provide productive jobs to prisoners, to meaningfully offset the cost of running the prison system, or to reduce the idleness and underemployment which were rampant in California's prisons."¹ This belief, along with the belief that constraints of state government severely impeded the ability of the PIA to operate on a self-supporting basis, led the Legislature to seek a more autonomous authority to operate the prison industries.

The PIA is different from most state departments or agencies because it is a relatively independent authority not subject to normal budgetary, agency, or departmental review. Being an authority, the PIA has its own board and Prison Industries Revolving Fund (PIRF), making it a highly autonomous and relatively low profile state government organization.

The PIRF is an internal service fund for "cost-reimbursement" enterprises. The fund is used for reimbursement from the PIA's primary customers, which are other state agencies.

Although an authority not under budget review, the PIA is legally part of the CDC as specified by Penal Code Section 5001. Section 5001 says, "The Department (meaning the CDC) is composed of the Director of Corrections and the Prison Industry Authority." However, the PIA is not represented as a line item in the CDC budget because the board has statutory authority to review and approve the annual budget for the PIA.

In the words of the PIA, it is "neither fish nor fowl." Some PIA managers consider the organization a "wholly owned subsidiary of the CDC."

In addition to its State of California organizational autonomy, the PIA has a number of advantages as compared to the private sector. **Exhibit 6**, at the end of this section, summarizes four categories of PIA competitive advantages as compared to the private sector.

¹ Historical and statutory notes to 1982 legislation establishing the PIA.

For each of the PIA's competitive advantages, there generally is an offsetting disadvantage as compared to the private sector. The PIA's most significant competitive advantage is its mandatory sourcing - state customers must buy PIA products. This mandatory use provision compensates in part for the prohibition of PIA selling its products and services on the open market.

As can be seen from this exhibit, the PIA currently has many advantages and disadvantages as compared to the private sector. A change in any one of the PIA's key competitive advantages would have a significant impact on the overall competitive position of the PIA versus the private sector.

**Scope and
Methodology of
Review**

The Joint Legislative Audit Committee approved a request to have the State Auditor conduct a performance audit in order to evaluate costs, quality, and service of the PIA. This performance audit was conducted between November 27, 1995, and March 27, 1996. This performance audit was conducted by Ernst & Young LLP, with major subcontractor assistance from NewPoint Group. The scope of work included the following areas of PIA inquiry:

- ☐ Findings on strategic planning efforts and performance measurement and benchmarking processes
- ☐ Findings on the adequacy of management control structures and cost accounting systems to effectively manage industry financial performance
- ☐ Estimated costs and profitability for selected products
- ☐ Assessment of pricing mechanisms used
- ☐ Competitive analysis of PIA products versus commercial business products versus other state correctional industry products in terms of cost, price, and quality
- ☐ Determination of whether legislative mandates or self-imposed policies adversely affect operations, revenues, or expenditures
- ☐ Recommendations to lower costs and improve services.

The scope of this performance audit was focused on business and operational aspects of the PIA. This performance audit emphasized the evaluation of PIA's ability to provide quality goods and services in a cost effective manner. Secondly, we reviewed the achievement of PIA's correctional program goals, such as maximizing inmate employment, teaching inmates marketable job skills, or reducing recidivism.

Specifically, the scope of this review included the following activities:

- ☐ Select six PIA products or product lines for product costing and comparison with similar private sector products or product lines
- ☐ Compare PIA products to private sector products from up to three private companies

-
- ☐ Compare PIA products to products from up to three state prison industry programs and the federal prison industry program
 - ☐ Analyze PIA operations data currently available from PIA records and systems.

In addition to numerous fact finding structured interviews with PIA staff and management, we interviewed several prior and current board members regarding the PIA mission. We visited six PIA facilities at San Quentin, Folsom State Prison, California State Prison Sacramento, Deuel Vocational Institution, California Men's Colony, and Richard J. Donovan Correctional Facility. Finally, we interviewed management of correctional industries operated by the states of Texas, Florida, and New York, and the federal government.

**Report
Organization**

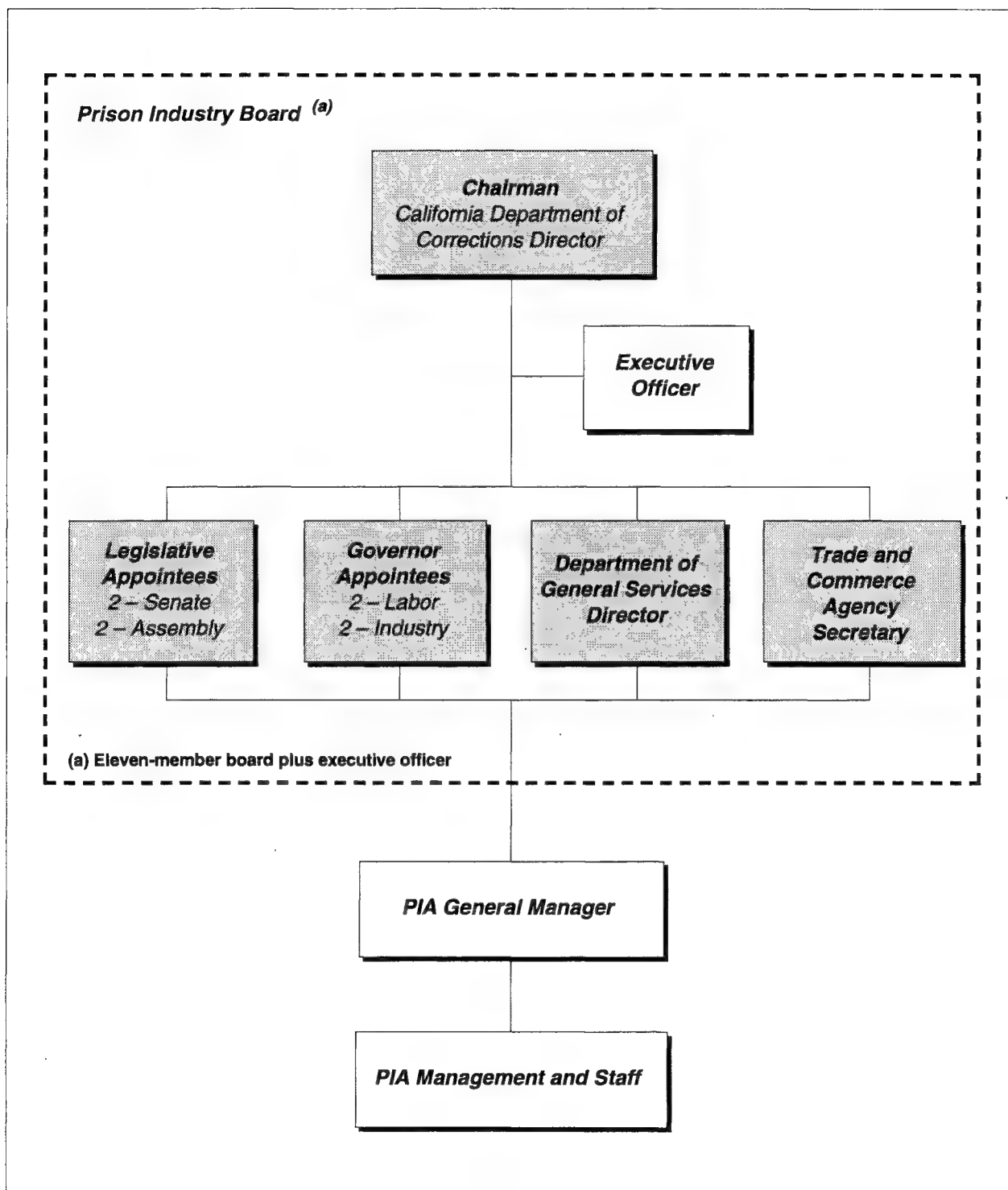
The remainder of this report is organized into the following five chapters:

1. The Prison Industry Authority Does Not Measure or Report On Its Programmatic Benefits, Is Not Self-Supporting, and Does Not Reduce the State's Costs
2. The Prison Industry Authority Is Unable to Manage Costs and Profitability of Its Products and Factories
3. The Prison Industry Authority Should Improve Its Operational and Financial Management Activities
4. Noteworthy Accomplishments of the PIA
5. Statutory and Regulatory Issues Adversely Affect the Prison Industry Authority Operations
6. Recommendations.

Finally, we have included, eight appendices with this report:

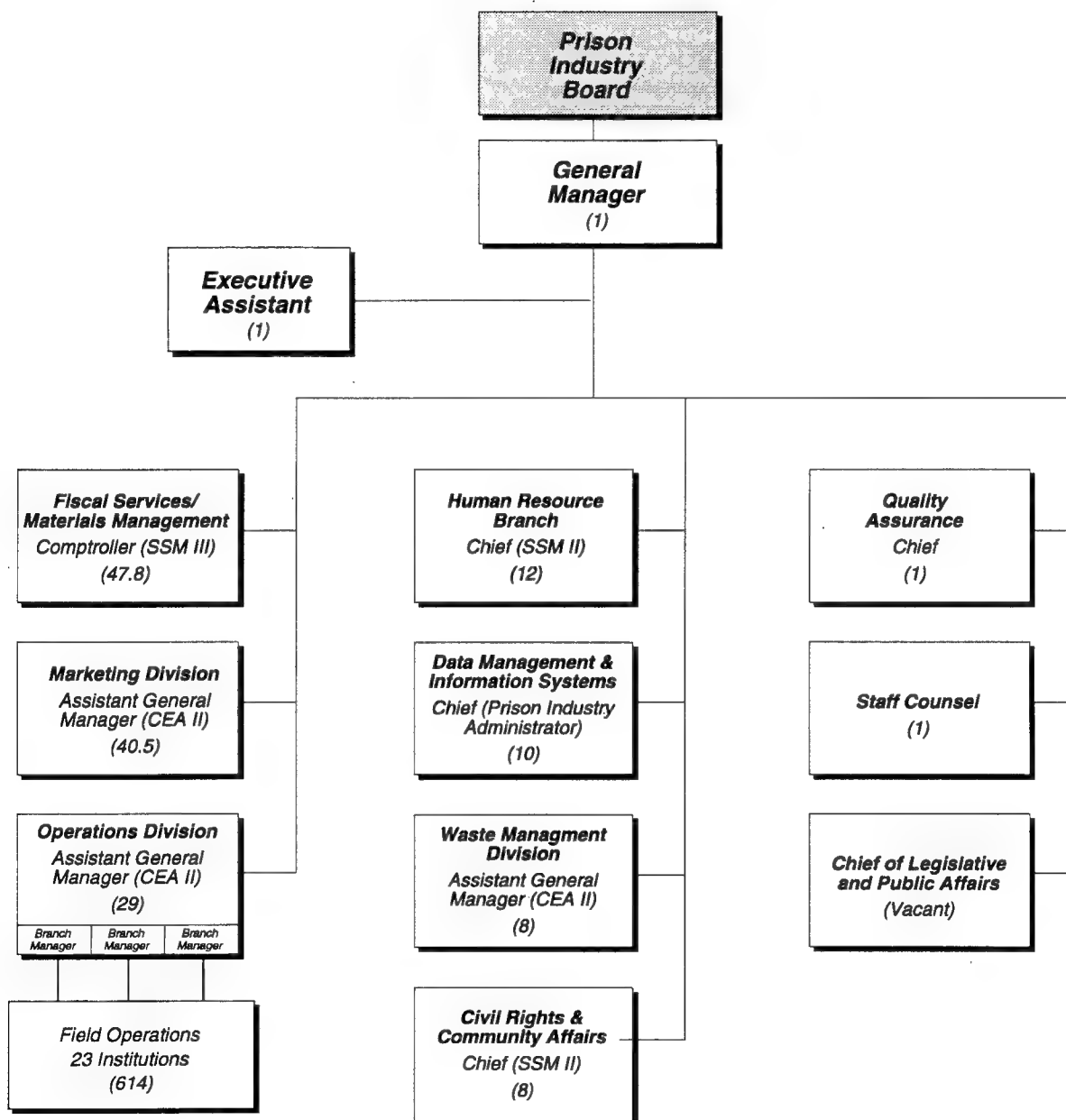
- A. Employment and Sales at California Department of Corrections Facilities
- B. Twelve-Year Historical Financial Results
- C. Annual Sales and Profits by Industry
- D. Prison Industry Authority Customer Satisfaction Survey
- E. Comparison of Prison Industries in Other States
- F. Statutory Requirements of the Prison Industry Authority
- G. Response to the Auditor's Report from the Prison Industry Authority
- H. Comments on the Response from the Prison Industry Authority.

Organization of Prison Industry Board Prison Industry Authority



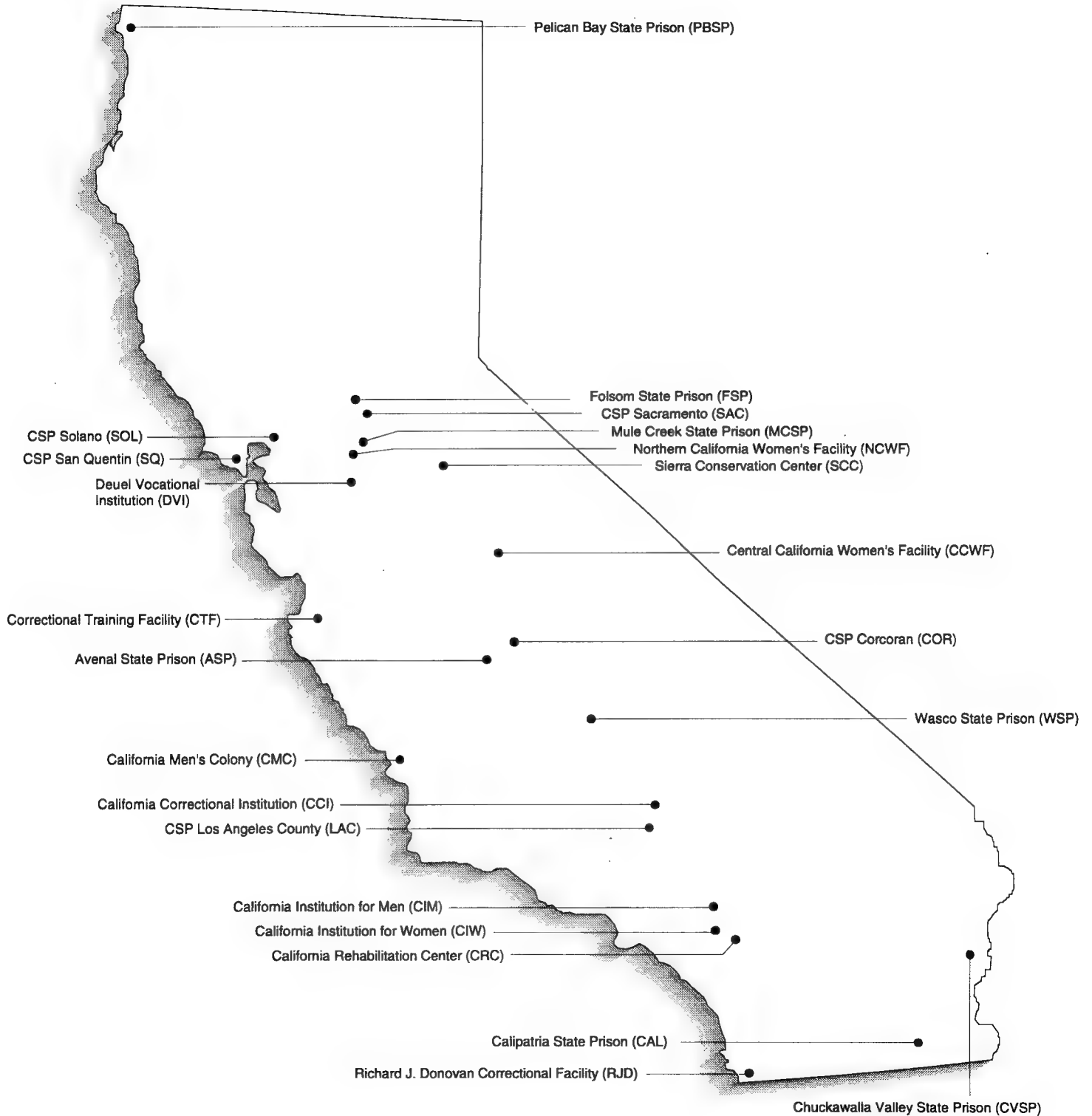
Organization and Staffing Prison Industry Authority

(Personnel Years in Parentheses) ^(a)



(a) There are 773.3 PYs listed above, the budgeted PYs for fiscal year 1995/96.

PIA Programs at 23 Department of Corrections Institutions



PIA Factories at CDC Institutions By Industry Group (73 Factories)

	23 CDC Institutions																						
	ASP	CAL	CCI	CCWF	CIM	CIW	CMC	COR	CTF	CVSP	DVI	FSP	LAC	MCSP	NCWF	PBSP	RJD	SAC	SCC	SOL	SQ	VSPW ⁽¹⁾	WSP
31 PIA Industries																							
Manufacturing																							
1. Fabric Products			♦	♦	♦	♦	♦	♦	♦					♦					♦				
2. Metal Products	♦								♦	♦	♦	♦								♦			
3. Wood Products	♦		♦						♦												♦		
4. License Plates												♦											
5. Shoes							♦									♦							
6. Precast Concrete																			♦	♦			
7. Bindery																			♦	♦			
8. General Fabrication								♦															
9. Mattress											♦							♦			♦		
10. Furniture Assembly & Refinishing																		♦					
11. Cleaning Products													♦										
12. Knitting Mill							♦																
13. Paper Products																		♦					
14. Metal Signs												♦											
15. Fiberglass														♦									
16. Silk Screening			♦														♦						
17. Textile Mill																	♦						
Services																							
18. Laundry	♦	♦			♦		♦	♦		♦			♦	♦	♦	♦	♦	♦	♦	♦			♦
19. Meat Cutting														♦									
20. Optical		♦											♦			♦	♦	♦		♦			♦
21. Printing							♦						♦				♦	♦					
22. Bakery																	♦						
23. Coffee Roasting														♦									
24. Materials Recovery Facility												♦											
25. Key Data Entry															♦								
26. Micrographics				♦																♦			
27. Dental Lab																							
Agriculture																							
28. Dairy Farm					♦			♦	♦		♦												
29. Eggs	♦																						
30. Chicken (Poultry)	♦																						
31. Crops				♦																	♦		♦

(1) Valley State Prison for Women began start-up operations during fiscal year 1994/95. There were no sales recorded for these factories during fiscal year 1994/95.

Summary of Prison Industry Authority Products ^{1/}

Bedding

- | | |
|--------------------------|--------------------------|
| 1. Bedspreads | 3. Pillows and Covers |
| 2. Mattresses and Covers | 4. Mattress Refurbishing |

Clothing/Textiles

- | | |
|------------------------|---------------------------------|
| 5. Safety Clothing | 10. Specialty Clothing |
| 6. Casual Wear | 11. Outerwear |
| 7. Sports Wear | 12. Privacy Curtain |
| 8. Underwear/Socks | 13. Draperies |
| 9. Nomex Fire Clothing | 14. Clothing with Silkscreening |

Shoes, Boots and Gloves

- | | |
|--|---|
| 15. Firefighter Boots | 18. Work Gloves, Men and Women |
| 16. Canvas Shoes | |
| 17. Dress, Work and Leisure Shoes (Men, Women) | 19. Welders Gloves - Firefighters Glove |

Flags

- | | |
|------------------------|-------------------|
| 20. Indoor and Outdoor | 22. United States |
| 21. California | 23. Departmental |

Detergents

- | | |
|-------------------|-------------------------|
| 24. Disinfectants | 27. Janitorial Supplies |
| 25. Laundry | 28. Utility Cleaners |
| 26. Dishwashing | 29. Bar Soap |

Food Services Equipment

- | | |
|---------------------|----------------------------|
| 30. Tables | 34. Insulated Food Carts |
| 31. Skids | 35. Food Grade Wall Panels |
| 32. Platform Trucks | 36. Food Racks |
| 33. Utility Carts | 37. Dunnage Racks |

Food Products

- | | |
|-------------|--------------|
| 38. Meat | 42. Eggs |
| 39. Sausage | 43. Chickens |
| 40. Bread | 44. Coffee |
| 41. Milk | |

Stationery Products

- | | |
|--|---------------------------------|
| 45. Brief Cases | 50. Decals, Stickers and Labels |
| 46. Conference Folios | 51. Log Books |
| 47. Business Card Holder | 52. Diploma Covers |
| 48. Products | 53. Custom Vinyl Products |
| 49. Ring Binders with or without Silkscreening | |

Fiberglass

- | | |
|-------------------------|---------------------|
| 54. Containers | 59. Wash Sinks |
| 55. Tables with Seating | 60. Tanks |
| 56. Lifeguard Towers | 61. Modesty Panels |
| 57. Wall Panels | 62. Custom Products |
| 58. Ash Trays | |

Open Office Panel Systems

63. Century 2000

Detention Equipment

- | | |
|----------------------------|--|
| 64. Total jail furnishings | 67. Architectural Design Items/Accessories |
| 65. Day Room | 68. Lockers |
| 66. Cell Equipment | 69. Mess Hall Tables |

Furniture (Wood and Metal)

- | | |
|-----------------------------|-----------------------|
| 70. Acoustical Screens | 76. Lunchroom |
| 71. Wood/Metal Office | 77. Lounge |
| 72. Computer | 78. Reception |
| 73. Library | 79. Steel Shelving |
| 74. Residence Hall | 80. Vertical Shelving |
| 75. Steel Wardrobe Cabinets | |

Special Services

- | | |
|-----------------------------------|-------------------------------|
| 81. Key Data entry | 86. Laundry |
| 82. Micrographics | 87. Silkscreening on Clothing |
| 83. Furniture Refinishing | 88. Reupholstery |
| 84. Dental Lab | 89. Printing |
| 85. Ophthalmic and Safety Eyewear | |

Miscellaneous

- | | |
|-------------------------|------------------------------|
| 90. Agricultural Crops | 95. Mechanics Creeper |
| 91. Corrugated Cartons | 96. Glove Pouches |
| 92. Concrete Precast | 97. Gun Cleaning Tubes |
| 93. Concrete Fire Rings | 98. Waste Management |
| 94. Silhouette Targets | 99. Weight Lifting Equipment |

^{1/} This listing is a broad cross section of PIA products as presented in the PIA's price catalog. There are approximately 1,748 "core" products and approximately 27,640 discrete products including different sizes and styles.

Advantages and Disadvantages Prison Industry Authority

Advantages	Disadvantages
<p>1. Monopoly State Sales and Built-In Growth Market</p> <p>California's Penal Code specifies that all products produced by the PIA shall be purchased by the State (mandatory sourcing) and state agencies shall make maximum utilization of these products. That is, whatever is produced by the PIA must be bought by state agencies if the item is identical, or similar, to what the agency intends to purchase. The Penal Code also specifies that state agencies shall consult with the PIA to develop new products and adopt existing products to meet their needs. Because 57 percent of PIA sales are to the CDC, and the CDC inmate population is projected to increase significantly, the PIA has a built-in and growing future market.</p>	<p>1. Exclusive Government Sales and No Private Sector Market</p> <p>The Penal Code does not allow sales of PIA products to non-government entities within the United States. Limiting PIA markets to governmental entities hinders production and sales efficiencies because greater quantities cannot be produced of each product line. This limited state market, along with the drive to maximize inmate employment, has contributed to a diversity of products and services that exceeds many conglomerates.</p> <p>The PIA is not allowed to enter any new industry, regardless of how cost-effective it operates, unless it is determined that it will not have a substantial adverse impact on California industry that cannot be mitigated. In the past twelve years, the PIA has had approximately sixteen proposed new or expanded enterprises either rejected or restricted due to these limitations.</p>
<p>2. Inexpensive Labor Source</p> <p>Inmates working for the PIA are paid from \$0.30 to \$0.95 per hour (depending on the labor classification and step level). The Penal Code specifies that inmate pay cannot exceed one-half the minimum wage. Additionally, the PIA does not pay benefits such as health insurance or social security taxes. The PIA has a very inexpensive labor force.</p>	<p>2. Inefficient Labor Source</p> <p>The inmate work force is relatively unskilled and uneducated. Also, the labor force is far less stable than found in the private sector. The turnover rate can range from 25 percent to over 200 percent a year due to inmate transfers, releases, and changes in work assignments. This causes the PIA to spend considerable time training an ever-changing work force. Also, because the PIA uses an inmate work force in a secured CDC environment, the work day can be reduced by as much as two hours in an eight hour work day. Examples of unproductive time are the need to constantly account for inmate location, to perform standing counts, and to make inmate searches at various points of ingress and egress. Finally, work is disrupted because of lockdowns and other legal or institutional requirements. The PIA estimates lost production hours due to lockdowns and other institutional reasons to equal 17 percent of their total labor hours. Production interruptions may cause the PIA to stockpile more inventory, thereby increasing product inventory costs. The PIA has an inefficient labor source.</p>
<p>3. Competitive Bid Waiver for Customers</p> <p>Because of the mandatory sourcing requirement, state agencies do not have to go through lengthy and costly competitive procurement to obtain PIA products. This advantage could potentially reduce the time for a PIA customer to receive product by up to six months versus a typical competitive procurement. Some PIA products can be obtained relatively quickly through existing State master contracts. State of California customers can order direct from the PIA, making them an attractive supplier.</p>	<p>3. Mandatory Competitive Procurement for Suppliers</p> <p>The PIA, just like any other state agency, is required to purchase their raw materials and supplies through the State's competitive procurement process, including minority, women, and disabled veteran business requirements. As a result, it can take the PIA from three to nine months to obtain raw materials needed for production. The PIA responds to these delays by building up raw material inventory, thereby increasing inventory carrying costs.</p>
<p>4. Other Advantages</p> <ul style="list-style-type: none"> <input type="checkbox"/> The PIA pays no local, state, or federal income taxes, allowing these cost-savings to be passed on to their customers. <input type="checkbox"/> PIA suppliers are assured of receiving full payment because there is little probability of PIA bankruptcy, thereby receiving favorable trading partner terms. <input type="checkbox"/> The PIA has the ability to borrow funds at tax-exempt interest rates and raise relatively large amounts of capital. The PIA also has received the benefit of large general fund capital contributions versus having to secure all capital through retained earnings or outside borrowings. 	<p>4. Other Disadvantages</p> <ul style="list-style-type: none"> <input type="checkbox"/> The PIA pays sales taxes on its purchased raw materials whereas the private sector does not. <input type="checkbox"/> The State's civil service system for hiring and terminating employees is inordinately complex and lengthy and the State has no incentive compensation structure. PIA free staff salaries (not including fringe benefits) may be more than 30 percent higher than comparable positions in the private sector. <input type="checkbox"/> The numerous and diverse PIA factories throughout the State at CDC institutions adds cost and complexity to PIA administration. <input type="checkbox"/> Each PIA factory manager is accountable to their respective CDC Warden, which constrains business operations and causes separate and distinct operation differences at each PIA institution.

Chapter 1

The Prison Industry Authority Does Not Measure or Report On Its Programmatic Benefits, Is Not Self-Supporting, and Does Not Reduce the State's Costs

The PIA has three statutory purposes: (1) to employ inmates, (2) to improve inmate work habits and occupational skills, and (3) to be self-supporting and to reduce the cost of operation at the California Department of Corrections (CDC). In this chapter we discuss why the PIA is not self-supporting and does not reduce the State's costs, as well as how neither the CDC nor the PIA have measured or reported the programmatic benefits of this penal program.

Correctional experts and the general public commonly support the premise that inmates should engage in a rigorous program of constructive labor. Interest in prison industry may be due to the fact that such programs have always sought multiple goals.

Utilizing inmates in institutional maintenance may reduce operating costs, and therefore, has an economic appeal. Employing inmates also reduces idleness, long thought to be an undesirable and counterproductive feature of prison life. Work programs also expose offenders to the norms and practices of the "world of work." Finally, prison industry jobs can provide the inmate with specific work skills.

In addition to these inmate-focused objectives, the PIA has been expected to: (1) present a minimal impact on the CDC budget, (2) be financially self-supporting, or (3) realize a profit to offset costs of other CDC programs. The cost of these prison industry programs is somewhat easier to measure, whereas the benefits are much more difficult to quantify. The multiple goals that prison labor serves makes it difficult to provide an unambiguous answer to the question: "Does California's PIA make a difference?"

Based on our review of financial information, including various subsidies, the PIA is not self-supporting and does not reduce the State's costs. Also, the PIA is unable to empirically demonstrate its success in meeting its stated primary program purposes, with the exception that it does employ some inmates. Considering state government as a whole, and including state taxpayers, the potential benefits of the PIA are still unclear.

**Neither the PIA
Nor the CDC
Measure or Report
the Programmatic
Benefits of This
Penal Program**

"The PIA Exists to Employ Inmates"

The PIA's first stated statutory purpose is to employ prisoners in institutions under the jurisdiction of the Department of Corrections. Of the PIA's three statutory purposes, the CDC and the PIA has consistently interpreted inmate employment as the overriding mission of this penal program. The two other purposes (develop work habits and occupational skills, and be self-supporting and reduce the costs of CDC operation) appear to have been secondary and subsidiary to this overall improvement goal.

The CDC and the PIA state that there are implied public benefits derived from the PIA including reduction in idleness of inmates, with a resulting alleviation of tension and violence. This behavior effect in turn creates operational benefits to the CDC. For example, the CDC and the PIA have stated that they believe the costs for security, academic education, and vocational training are lower at institutions with prison industries. While we do not doubt that happily employed inmates are easier to handle and control, we noted that neither the CDC or the PIA have measured, quantified, or reported these benefits. Moreover, we found no empirical evidence to support the theory that institutions with prison industries have lower operational costs.

In order to analyze the effectiveness of the PIA's employment activities, we analyzed the PIA's employment of inmates and free staff since its inception. We found that the number and percentages of inmates employed by the PIA have declined.

**Inmate
Employment Has
Declined**

Since fiscal year 1989/90, the number of inmates employed by the CDC has declined by 9 percent, while the number of state employees working for the PIA has declined by 3 percent. The PIA is having a diminishing impact on providing programming alternatives to the CDC's rapidly growing inmate population.

As of June 30, 1995, the total CDC institution population was 121,470 inmates. At this same time, the PIA employed 7,012 inmates, or 5.8 percent of the total CDC institution population.¹ **Appendix A** to this report shows comparable population and employment figures for the 12 years ending June 30, 1995. The most inmates ever employed by the PIA was 7,962 in 1991. The highest percentage of inmates employed was 10 percent 8 years ago.

The percentage of inmates employed by the PIA has dropped in six of the past seven years, as depicted by **Figure I-1**. These data reflect both the PIA's deemphasis on the inmate employment goal and the fact that the PIA is finding it harder to keep up with the rapidly growing prison population.

¹ The 7,012 inmates employed by the PIA is determined as the headcount on June 30, 1995. Based on actual numbers of hours worked by, and paid to inmates, the full-time equivalent employment during fiscal year 1994/95 ranged from 4,404 to 5,872.

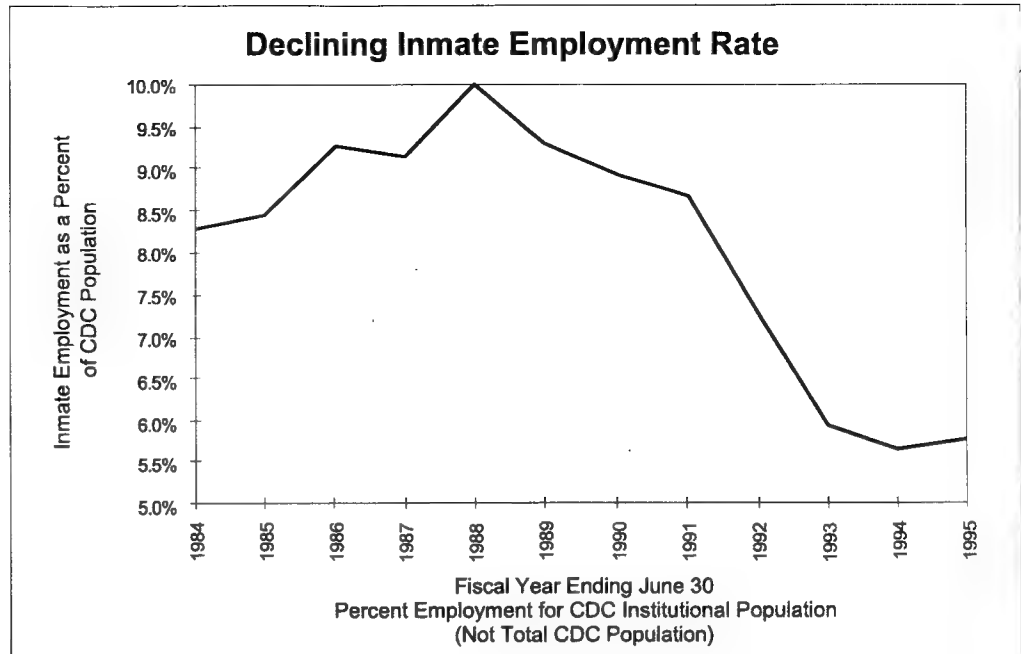


Figure I-1

In the early 1980s, the PIA was planning for a rapid and substantial expansion in order to comply with inmate employment mandates related to new prison construction. At that time, the CDC was developing work plans to provide employment opportunities for all able-bodied inmates in state prisons.

As recognized by the PIA at the time the CDC established the policy, employing 42 percent of inmates is clearly an unrealistic goal. This rate has never been achieved in California nor anywhere else in the United States.

Figure I-2, on the next page, graphically shows the employment rate at correctional industries in other states.

California's PIA employment rate ranks 33 of 50 state programs, and is fourth among the eight states that house more than 30,000 inmates. The California PIA employs the second highest number of inmates (Texas is largest). The Federal prison industry employs 16,000 inmates, the highest of all correctional industries, or 17 percent of 90,000 Federal inmates.

Appendix A to this report shows that between fiscal years 1994/95 to 1995/96, the prison population is expected to increase 11.5 percent to about 146,390 inmates. The most recent Governor's Budget contains estimates that prison population will continue to increase steadily, surpassing 230,000 inmates by the end of the decade (fiscal year 2000/2001). This is a 77 percent increase over today's prison population. Given these growth estimates and the scheduled completion of new prison beds, we conclude that California prison overcrowding (as measured against design capacity) will worsen by the end of this decade.²

² Legislative Analyst Budget Bill Review, Fiscal Year 1995/96, Page 31.

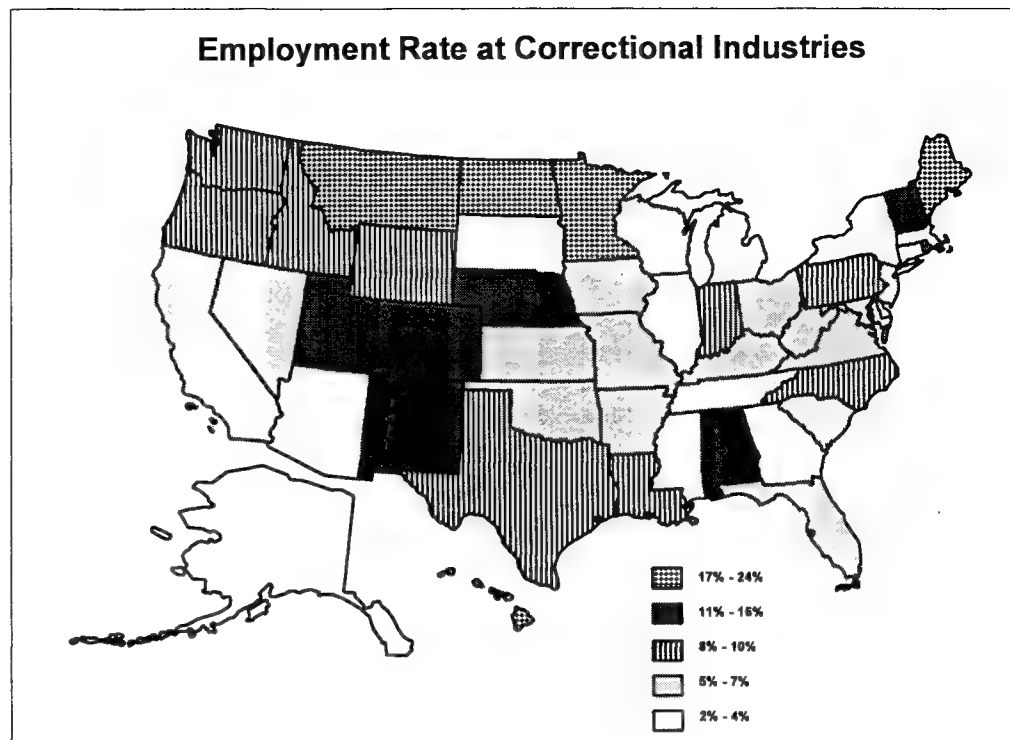


Figure I-2

The majority of current inmates are incarcerated for nonviolent offenses, and are between the ages of 20 to 34 years of age. Given this composition and profile, the CDC population appears to consist of able-bodied inmates.

As of December 31, 1994, California's incarceration rate is 384 prisoners (with a sentence of more than one year) per 100,000 population. This rate is in the top one-third of the 50 states, as some states have a much higher rate (most notably, Texas ranked number 1 at 636). The U.S. average incarceration rate is 387. We do not believe California's incarceration rate correlates to its inmate employment percentage.

Figure I-3, on the next page, shows the gap between the CDC's inmate population and the number of inmates employed by the PIA. This gap is expected to widen over time. The graphic demonstrates how unrealistic it may be to establish high employment rates as an overriding goal of the PIA.

Over the last four years, from fiscal year 1990/91 to fiscal year 1994/95, PIA inmate employment declined 12 percent, from 7,962 to 7,012 inmates. During this same time period, sales per inmate employed increased 17 percent, from \$18,500 to \$21,700. These figures show that inmate employment does not have to keep pace with growth of the PIA organization.

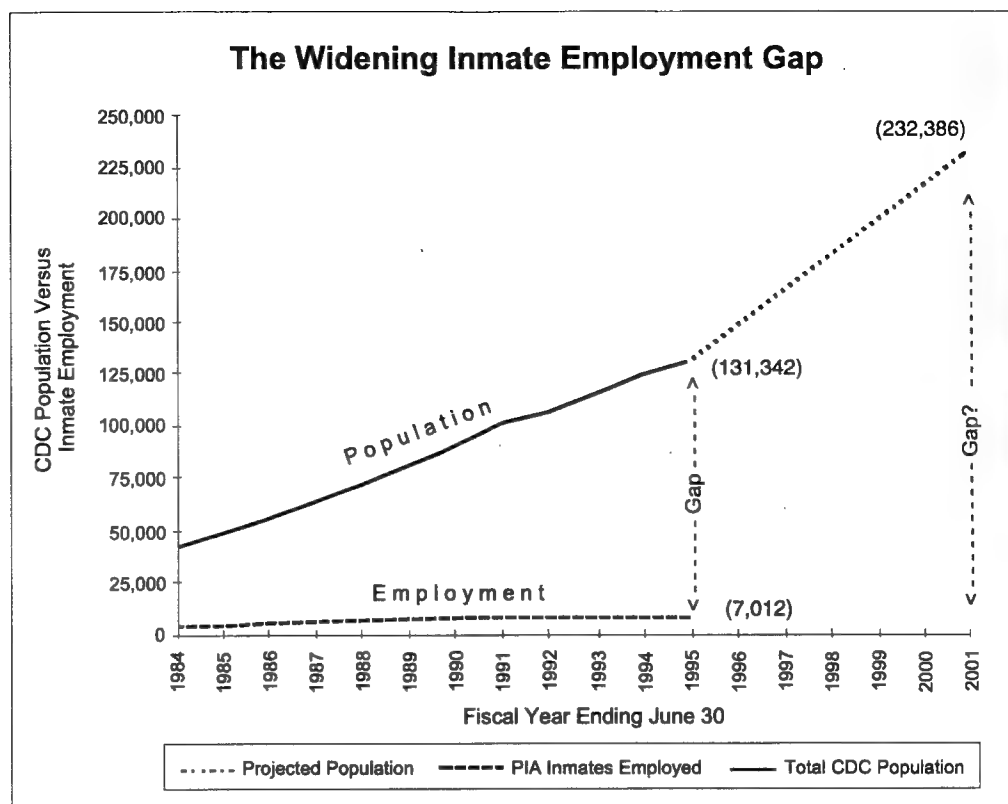


Figure I-3

California is ranked 14 out of 48 states in terms of 1994 sales per inmate employed, with Iowa, New York, Illinois, and Florida ranking in the top four.³ These four states range from \$27,466 per inmate in Florida to \$32,551 per inmate in Iowa. California with 1994 sales of \$21,700 per inmate may have future growth potential.

Sales per inmate employed generally has increased each year over the last 12 years. Since 1984, PIA sales per inmate increased 94 percent while the consumer price index increased 41 percent. Adjusting for price inflation, real sales per inmate have substantially and consistently grown over time. It is clear that PIA sales are not closely linked to PIA employment.

Both the number of inmates and free staff employed by the PIA declined. Since fiscal year 1989/90, PIA free staff declined three percent, from 698 to 674 free staff.⁴ The number of inmates employed per PIA free staff declined six percent during this period, from 11.1 to 10.4. Meanwhile, sales per free staff increased significantly to approximately \$226,000, a 37 percent increase.

³ Nebraska and Wyoming did not report sales for 1994.

⁴ State Controllers Office provided actual personnel-years paid for both fiscal years 1989/90 and 1994/95.

In summary, during the 1990s, inmates employed has declined nine percent and free staff employed declined three percent. Meanwhile, sales increased. In terms of staff productivity over the past five years, inmate leverage (i.e., the ratio of inmates to free staff) has declined slightly, and sales per free staff increased by over one-third.

It is interesting to note how constant PIA sales are when adjusted to CDC's population. In fiscal year 1983/84, PIA sales per employed inmate were \$840. In fiscal year 1994/95, this ratio was \$1,159, a 38 percent increase. During this same time period the Consumer Price Index increased 41 percent, showing no real growth in total PIA sales per total CDC population. This comparison illustrates how important the CDC is to the PIA, and that sales to the CDC appear to be saturated, except when CDC's inmate population grows.

"The PIA Exists To Develop Inmate Work Skills"

The PIA's second stated statutory purpose is to help inmates acquire or improve effective work habits and occupational skills. This purpose implies that the PIA can provide inmates with occupational skills so that after their release there will be a reduction in recidivism. Neither the PIA nor the CDC has measured or reported the benefits of this statutory purpose.

When this benefit area is discussed, the PIA points to a federal study on how employment impacts recidivism. However, the PIA has not shown whether or not the PIA actually creates these kinds of benefits for California.

Only a handful of studies have tried to measure the effectiveness of prison job programs. There is very little research evidence concerning the effect of prison industry employment on inmate behavior while inmates are confined, or after their release.

A sophisticated and well designed study published in 1991 by the Federal Bureau of Prisons, Office of Research and Evaluation, found that the federal program reduces recidivism.⁵ The four-year study traced more than 7,000 federal inmates for one year after their release. This major research study found that the Federal Prison Industries, known as UNICOR, could lower the number of inmates sent back to prison within the first 12 months by as much as 35 percent.

A similar study, published in 1988, was conducted by New York State University, in conjunction with the Division of Industries of the New York State Department of Correctional Services.⁶ This study investigated the impact of prison industry employment on offender behavior.

⁵ Federal Prisons Journal, William G. Saylor and Gerald G. Gaes, *The Post-Release Employment Project*, Winter 1992.

⁶ The Hindelang Criminal Justice Research Center, Timothy J. Flanagan and Terence P. Thornberry, *The Effect of Prison Industry Employment On Offender Behavior: Final Report of the Prison Industry Research Project*, January 29, 1988.

This objective New York analysis of two large samples of inmates found that the effect of this prison work program on recidivism was insignificant. In fact, the recidivism rates of the industry participant and nonparticipant groups were virtually identical.

The New York research did find, however, that participation in their prison industry had an important effect on inmate conduct within the prison environment, but that this was largely unrelated to post-prison recidivism. Inmate conduct was measured in terms of the number of institutional disciplinary infractions.

The above research studies suggest that results will vary by program type and composition of prison inmates. For example, results from the federal inmate program, which houses a higher percentage of white collar criminals and has its own unique program, may or may not be applicable to California. The same also could be said for the New York research.

There is little argument that the PIA employment program might have an impact on inmate work habits and work ethic. Having inmates familiar with time clocks, job descriptions, quality improvement teams, and customer satisfaction can give them valuable experience that they can use when they leave the system. However, neither the CDC nor the PIA have measured or reported these benefits. Most significantly, there is little evidence that the PIA's program has any measurable impact on inmate employment after release and/or a corresponding reduction in recidivism.

If the CDC and the PIA's goals are to develop employment skills as a core objective, then the PIA does not consistently execute a systematic PIA hiring practice, where inmates are consistently screened for education prerequisites or the length of their sentences. It has been described to us that many inmates are more likely to sign up for job programs when "they've got a long time to occupy themselves."

If reducing recidivism is a core objective, the PIA does not always employ the inmates who will eventually be released and have a chance to succeed in the outside world. In other words, the PIA does not consciously minimize the use of inmates with true life sentences. In general, the PIA has very loose criteria for its selection of inmates for employment.

The PIA does not make an effort to track inmates once they leave the PIA or are released. Also, the PIA has not established or employed a job placement mechanism which helps inmates find work when they are released from prison.

Specifically, the PIA has no formal program to follow inmate employees to the outside world in terms of either assistance or measurement. For example, there is no organized "letter of recommendation program" for the more outstanding inmate employees to use when they apply for jobs.

There is no systematic attempt to match inmate employment skills with outside opportunities. For example, there are very few textile manufacturing jobs available in California for inmates formerly employed at the R.J. Donovan textile mill.

The marketability of PIA inmate work skills is questionable. Some PIA jobs are in fields with a labor surplus, which utilize outmoded equipment and production techniques, or require licenses that are difficult for convicted felons to obtain.

The PIA cannot know whether it is providing relevant employment opportunities or improving occupational skills, if the PIA does not try to measure results of its program. The PIA appears to be unable or unwilling to do the kind of tracking and research necessary to determine if it provides inmates with marketable skills.

Finally, the PIA claims that five or more years ago, it placed more emphasis on its programmatic aspects. However, the PIA claims that it now has largely abandoned these efforts due to external pressures to make the program more self-supporting.

**The PIA Does Not
Reduce the State's
Costs**

"The PIA Exists to Reduce Operations Costs"

The PIA's third stated statutory purpose is to operate a work program that will ultimately be self-supporting. Here the purpose is to be self-supporting and to reduce costs of operation at the CDC.

Because the PIA operates a penal program directed by legislative mandate, we believe it is unfair to compare the PIA's profitability and rate of return with private sector companies. The PIA is a penal program that is supposed to provide state benefits that offset costs of the PIA program.

The true costs of the PIA include its unsubsidized operational costs plus its subsidized costs from the other state agencies, less costs incurred on work PIA does for the CDC but for which it receives no payment. The benefits of the PIA are its penal program benefits and, if prices for products are below market, the savings to its customers.

The PIA points out that statutes only mandate that the PIA be self-supporting, not that each product be self-supporting. The problem with this reasoning is that unprofitable PIA factories result in additional costs to state agency customers because prices for products produced by "profitable" factories are much higher than the PIA's full cost to make the products, and these "profits" offset losses at other factories. The CDC purchases many of these products that subsidize inefficient factories. Again, neither the PIA nor the CDC have demonstrated that the inmate work program reduces the overall costs to CDC operations.

The PIA organizational structure itself does not provide a formal mechanism to return a dividend or benefit stream to the CDC. Any PIA benefits, in terms of net income, accrue to the PIA.

From its inception through June 30, 1995, the PIA has received \$108.8 million in cumulative contributed capital from the State of California (see **Appendix B**). The State contributed the majority of this capital in fiscal years ending June 30, 1987, 1988, and 1989. Had the State invested in a low-risk financial institution account at 4.5 percent per annum interest rate, cumulative economic earnings would have amounted to \$40.5 million in real income over the 12-year period.

In return for this \$108.8 million capital contribution, the State correspondingly had 73,157 inmates participate in the program over this same 12-year period. We found no measurable evidence of the penal programmatic benefits of the PIA program to help offset these costs.

When the State contributed capital to the PIA, the Legislature expected benefits from this contribution. The Legislature, the CDC, and the PIA all envisioned that the PIA would be effective because of its inexpensive labor and closed market. Unfortunately, the benefits of this PIA program have yet to be measured empirically.

The PIA's drive for employment created perhaps the most number of products for any correctional industry in the United States. This large number of products resulted in many costlier operations and hence more costly products and services. These higher cost products and services in turn are passed along to state agency customers. In other words, the implied need to employ inmates had a corresponding cost to the State which is hidden in the budgets of every purchasing state agency. These employment costs should have offset employment benefits.

The primary means for the PIA to reduce costs of CDC operations is to: (1) provide program employment benefits, and/or (2) provide goods and services to the CDC at prices lower than market. The PIA has not conclusively measured or reported on either of these benefits.

**The PIA Is Not
Self-Supporting
and Has Not Paid
All Expenses of
the Program**

Among provisions of California Penal Code Section 2801, the PIA is to operate a work program for prisoners which will ultimately be *self-supporting* and reduce the California Department of Corrections cost of operations. Although the PIA has recorded a net income over the past two fiscal years, it has been heavily subsidized throughout its 12-year history because of the continuing interest-free capital contributions since fiscal year 1983/84, as well as significantly subsidized rent for the facilities which it uses but does not own. As a result, the PIA is unable to determine how effective it is at supporting itself or lowering the costs of the CDC. These two subsidies may have been \$13 million (see Table I-4) in fiscal year 1994/95, eliminating the reported net income of \$9.9 million reported in PIA's annual

financial statements. The PIA also is not paid by the CDC for security-related work which the PIA performs. Other subsidies which were not measured include insurance and exemption from local, state, and federal income taxes.

**The PIA Does Not
Pay Interest
on \$109 Million
of Capital
Contributed By the
General Fund**

We reviewed 12 years of the PIA's financial statements through June 30, 1995, and analyzed the non-refundable contributions of cash, buildings, and equipment to the PIA. There has been a continuous stream of these capital contributions since fiscal year 1983/84. Approximately \$109 million has been contributed from various sources, such as Federal grants, the 1986 Prison Construction Fund, and the Public Building Construction Fund. These funds were used to construct and purchase buildings and equipment. The PIA recognizes depreciation of these assets, but it has paid none of the interest expense to finance these purchases.

The State's General Fund, which pays the interest on PIA's contributed capital, has provided a significant subsidy to the PIA by not charging the PIA any interest on the capital contributions. The present value of the total interest subsidy through June 30, 1995, is estimated at \$54 million. For the fiscal year ended June 30, 1995, PIA's interest subsidy is estimated at \$5.4 million.

We estimated the interest rate that would have been paid by the PIA had it, rather than the General Fund, made interest payments on the contributed capital. We assumed the interest rates for Baa-rated State and Local Government Bond Dividend Yield for each respective year.⁷ During three fiscal years, 1986/87 through 1988/89, the PIA received \$62 million from the Pooled Money Investment Board (PMIB) as an advance on a \$62 million prison construction bond. The PIA paid an 8.5 percent interest rate to the PMIB on funds received in advance of these bond proceeds, but did not pay interest on the subsequent \$62 million bond proceeds.

For each of the prior 12 fiscal years, we multiplied the contributed capital by the assumed interest rate to determine the interest cost to finance the PIA's contributed buildings and equipment. We assumed that all contributed capital is refinanced each year at that year's assumed interest rate. The annual costs then were expressed in today's dollars using the annual change in the Consumer Price Index for All Items (West Region), published by the U.S. Department of Labor. We did not assume any principal portion of the contributed capital was paid by the PIA, nor did we assume that interest cost was compounded each year.

⁷ This assumed interest rate is less than the actual interest rate paid by the PIA on advance funding from the Pooled Money Investment Board to cover eligible costs prior to the issuance of the 1986 general obligation bonds sold to finance the 1986 Prison Construction Fund.

Table I-1, below, shows a summary of the interest cost associated with capital contributions in actual year dollars and at its future value in fiscal year 1994/95 dollars. The PIA has been provided a subsidy of nearly \$54 million for the buildings and equipment it used to produce and sell its products. This subsidy is over three times the cumulative net profits that the PIA earned since it was formed.

Table I-1
Interest Subsidy Provided to the PIA

Fiscal Year	Cumulative Contributed Capital	Interest Rate ^(a)	Interest Cost ^(b) (Nominal Dollars)	Interest Cost ^(c) (1994/95 Dollars)
1983/84	\$18,500,197	9.5	1,756,345	2,625,965
1984/85	18,500,197	10.0	1,846,320	2,647,951
1985/86	18,500,197	8.7	1,603,042	2,247,138
1986/87	18,741,356	7.9	1,482,214	2,008,664
1987/88	21,785,276	7.5	1,622,079	2,111,426
1988/89	59,665,339	5.2	3,103,269	3,857,760
1989/90	71,296,633	6.7	4,760,468	5,607,229
1990/91	97,525,577	6.1	5,963,645	6,727,727
1991/92	99,176,164	6.7	6,623,932	7,225,500
1992/93	107,207,395	5.9	6,346,295	6,732,784
1993/94	108,004,291	5.8	6,262,660	6,450,540
1994/95	108,811,385	5.0	5,420,393	5,420,393
Totals			\$46,790,662	\$53,663,077

(a) For purposes of this table, interest rate is determined by dividing Interest Cost by Cumulative Contributed Capital.

(b) This is the estimated interest that would have been paid by the PIA had it, not the General Fund, made interest payments. We assume no pay down of principal and no compounding of interest. The contributed capital is assumed to be refinanced each year at that year's assumed interest rate.

(c) Interest subsidy expressed in fiscal year 1994/95 dollars, using the Consumer Price Index.

The PIA Is Receiving Significant Rent Subsidies

While some facilities have been constructed for the PIA on CDC property, the PIA also rents facilities from the CDC at various institutions. A review of invoices indicates that the PIA typically pays between \$0.01 and \$0.03 per square foot for facility and warehouse space. Because these rented facilities are on, or immediately adjacent to, prison property, fair market rental rates are difficult to determine. It is clear, however, that the rates currently charged are well below fair market rates throughout the State, and well below a rent which

is required to recover the construction costs of these facilities. This rent subsidy to the PIA may have ranged from \$2.2 million to \$7.4 million during fiscal year 1994/95.

The PIA should pay rates that, at a minimum, are sufficient to recover the construction and related carrying costs of any facility it occupies but does not own. **Table I-2**, below, summarizes the rent required per square foot to recover the cost of constructing and financing a 50,000 square foot warehouse, excluding the cost of land, other improvements, and monthly maintenance.

Table I-2
Rental Charge per Square Foot Required to Recover
Construction and Financing Costs of a Warehouse

	Per Square Foot
Cost to Construct New Warehouse	\$20.00
Monthly Carrying Cost of Construction at 8.50% Bond Interest Rates	\$0.14
Monthly Investment Required to Accumulate Amount Sufficient to Repay Bond Principal in 21 Years (Compounded at 6.5%)	\$0.04
<u>Monthly</u> Rental Charge Required to Recover Cost of Construction and Related Carrying Costs	\$0.18
<u>Annual</u> Rental Charge Required to Recover Cost of Construction and Related Carrying Costs	\$2.16

As shown above, the annual carrying cost of a basic warehouse facility, with no land, improvements, or maintenance costs, is approximately \$2.16 per square foot. The above analysis assumes the use of prison construction bond proceeds to finance the construction at an annual interest cost of 8.5 percent. We also assume that a portion of each monthly rental payment would be invested to accumulate an amount sufficient to repay the bond principal in 21 years.

We did not obtain the total square feet of warehouse and factory space that the PIA rents. However, we did obtain the total rent paid by the PIA for all rented facilities in fiscal year 1994/95, which was \$434,000 (excluding the "Prompt Delivery" warehouse). Dividing this figure by the two different monthly rental charges per square foot provides estimates for a lower and upper bound of total square feet rented.

In other words, if we assume that all PIA facilities were rented at either \$0.01 or \$0.03 per square foot monthly, the PIA rented from 1.2 million to 3.6 million square feet during fiscal year 1994/95. In fact, the total square feet lies somewhere between these two estimates.

When we compare the estimate of the rental charge per square foot required to recover costs of a warehouse with the total square feet rented by the PIA, we can estimate the range of PIA's rent subsidy. As **Table I-3** shows, on the next page, rent subsidy may have ranged from \$2.2 million to \$7.4 million for the year ended June 30, 1995, with an average of \$4.8 million.

Table I-3
Range of Rent Subsidies

	Assuming Monthly Rent @ \$0.01 Per Sq. Ft.	Assuming Monthly Rent @ \$0.03 Per Sq. Ft.
Estimated Total Square Feet Rented	3,616,667	1,205,556
Annual Rental Charge per Sq. Ft. Required to Recover Cost of Construction and Related Carrying Costs	\$2.16	\$2.16
Total Annual Rent Expense	\$7,812,000	\$2,604,000
Actual Rent Expense for Year Ended June 30, 1995	(\$434,000)	(\$434,000)
Estimated Rent Subsidy	\$7,378,000	\$2,170,000

Although the method we use here does not provide the precise subsidy, it does clearly point to the fact that the PIA is receiving a substantial benefit resulting from below market rental rates at its facilities. This subsidy is not reflected in the costs or profitability of any product or industry, thus distorting the financial performance reported by the PIA. This subsidy does not reduce the State's cost of the PIA, but instead shifts some of the costs to the General Fund. As a result, PIA may be operating factories and producing products that are unprofitable and not cost-effective.

The PIA Performs Unfunded Work for the CDC

Because the PIA operates in a prison environment, the PIA performs several routine activities that do not occur in a commercial business. These include standing counts, institution searches, acting as Warden of the prison in his or her absence, and completing two inmate time cards for the CDC. During 1995, this work may have involved 43 full-time equivalent PIA staff (or personnel years). The average salary of one PIA field staff in fiscal year 1994/95 was \$44,300. Assuming an additional 25 percent for fringe benefits, this work for the CDC may have cost the PIA \$2.4 million in 1995. Because the CDC does not reimburse the PIA for this work, this constitutes a subsidy from the PIA to the CDC.

In a response to our inquiries, the PIA identified nine activities it performs that it believes are routine, non-PIA activities for the CDC, and estimated the total staff hours in 1995 for these activities. For each activity, we then asked the question: "Would CDC have to perform this activity if the PIA were not at the prison?" If the answer was yes, then the activity performed for the CDC is work for which the PIA is not reimbursed. If the answer is no, then the activity is not unfunded work and would disappear if the PIA did not exist. We then totaled the hours for those activities which the CDC would have to perform even if the PIA did not exist, and estimated the PIA's total personnel cost to do this work. The results are displayed in **Exhibit I-1**, following this page.

The most significant subsidy provided to the CDC is the nearly 63,000 hours per year that PIA field staff must spend to complete two separate CDC time cards, in addition to the third time card already maintained by the PIA for every inmate. Regardless of the CDC or PIA program in which the inmate participates, the inmate's supervisor must complete Form 1697 for the inmate each day, and then transfer most of this information to Form 191. A machine can read optically the second CDC form and record automatically the data for use by a CDC automated inmate tracking system. The information is used to accumulate sentence reduction time for each inmate.

The CDC's poorly designed time card system is inefficient, redundant, and wasteful. According to the PIA, no one at the PIA or the CDC uses some of the information recorded on the first form (1697), so collecting it is unnecessary. All the information on the second form (191) already appears on the first form, so completing both forms is unnecessary. Finally, the PIA uses an internal time card system that already records much of the required information needed by the CDC, so using the CDC forms is wasteful.

If approximately 69,000 inmates participate in a sentence reduction program for up to 250 days per year, and if it takes one minute per day to complete just one of the CDC forms, then CDC staff may spend nearly 287,000 hours performing non value-added redundant work. The CDC time card system appears to be inefficient.

The PIA currently is selecting a technology vendor to implement pilot projects at three prisons to test an integrated inmate time-keeping (CDC) and payroll (PIA) system. The purpose of these three pilots is to demonstrate a system that could provide information needed by both the CDC and the PIA but that would require information only be collected once. If both the CDC and the PIA approve the pilot results and make appropriate modifications to the pilot systems, then the PIA expects to install the system at all PIA sites. The PIA expects to implement the system at all PIA sites by Fall 1996.

Work Performed by the PIA As a Subsidy to the CDC

Activity	Hours Spent by PIA (1995)	Would CDC Have to Perform?	Actual Subsidy Hours
1. Institution Searches	420	Y	420
2. Administrative Officer of the Day Duties ^(a)	648	Y	648
3. Institution Meetings	4,691	N	0
4. Tool Control	33,224	N	0
5. Pat Searches ^(b)	11,244	N	0
6. Factory Searches ^(c)	13,209	N	0
7. Standing Counts ^(d)	12,442	Y	12,442
8. Form 1697	36,456	Y	36,456
9. Form 191	26,220	Y	26,220
Total	138,554		76,186
	Hours per PY ^(e)		1,771
	Total PYs		43
	Average PIA Salary		\$44,300
	Plus 25% Fringe		\$55,400
	Cost of Activities		\$2,382,200

(a) The PIA industries supervisor is acting Warden several times each year.

(b) Pat searches of inmates are done when an inmate passes from one area to another.

(c) Factory searches are performed when a tool is missing or at other times, as directed by the CDC.

(d) Standing counts of inmates are done at certain intervals during the day, regardless of where an inmate might be.

(e) A PY is a personnel-year, or full-time equivalent employee.

**The PIA's
Financial
Statements Are Not
a Good Indicator
of the Taxpayers'
Cost**

The PIA's financial statements are properly prepared in accordance with generally accepted accounting principles and audited annually by a certified public accountant as required by law. However, generally accepted accounting principles do not address situations in which a government entity receives non-cash subsidies from another segment of the government. Nonetheless, we believe that we must examine the PIA from the perspective of how it affects the taxpayers.

In **Table I-4**, below, we adjust PIA's "net income" to show the effects of recognizing PIA's subsidies and cross-subsidies. We estimate that the PIA actually incurred a net income of \$2 million during fiscal year 1994/95 when you recognize the effects of the subsidies.

**Table I-4
Partial Economic Adjustments
to the PIA's Audited Financial Statements**

	Fiscal Year 1994/95
Net income	\$9.9 million
Less: Interest not paid on contributed capital	(5.4)
Less: Rent subsidy from the CDC	(4.8)
Plus: CDC work performed by the PIA	<u>2.3</u>
Net Income	\$2.0 million

The PIA recorded its highest net income last fiscal year 1994/95. The long-term effects of these subsidies are more significant than last fiscal year. The PIA's retained earnings (net profits) over the last 12 years were approximately \$21 million. Over the same 12 years, the PIA's total interest subsidy was \$54 million. This is a net loss of \$33 million, not including the effects of the rent subsidy and the unfunded work performed by the PIA for the CDC.

Another reason that the PIA's financial statements are not a good indicator of taxpayers' costs is that the concept of profit is not appropriate for an entity like the PIA. From the taxpayers' perspective, one state agency cannot generate a "profit" by selling a good or service to another state agency at a price above full costs. Doing so is simply shifting taxpayer funds from one agency to another.

Finally, the PIA's unrecognized subsidies are not the only reason why we conclude that the PIA is not self-supporting. Every time the PIA charges one of its governmental customers a price higher than the market price, taxpayers

subsidize the PIA's activities . We discuss the PIA's prices and their effects in the following section.

**PIA's Customers
Pay High Prices to
Subsidize Inmate
Work Programs**

Total PIA revenues exceeded costs by \$9.9 million in fiscal year 1994/95. This "net income" was left over after the PIA incurred net losses in 42 percent of its factories totaling \$8.6 million. Products made in the remaining 58 percent of PIA's factories sold at prices averaging 17 percent higher than what was required for the factories to be self-supporting. These factories funded PIA's entire residual net income and subsidized significant losses at factories with inefficient inmate work programs. State customers buying products from "profitable" PIA factories paid prices higher than was necessary in order to subsidize other factories that were not self-supporting.

Subsidized Factories

For a factory to be self-supporting, its products must be priced to cover its full cost of production plus a "contribution margin" to cover its proportionate share of the PIA's non-production costs for selling, general, administrative, and other activities. These non-production costs totaled \$20.6 million, or 13.56 percent of PIA sales, in fiscal year 1994/95.

During fiscal year 1994/95, the PIA operated 41 factories (58 percent of its 71 factories in operation) with a net gain and 30 factories (42 percent) with a net loss, if we assume full costs for production, plus the 13.56 percent contribution margin for non-production costs. The 41 factories with a net gain collected \$18.5 million in excess of the cost necessary to fully sustain these operations.

The PIA used this \$18.5 million to fund \$8.6 million in losses at 30 remaining factories, and provide the PIA with a net income of \$9.9 million. The PIA retains this net income for use at the PIA's discretion in future years. Because the State's General Fund contributed most of the capital needed to construct PIA facilities and purchase the equipment used (and is not reimbursed), and because the PIA uses net factory gains to offset other factory losses during the year, the PIA's annual net earnings have accumulated since 1982 and have contributed to the PIA's \$30.2 million cash reserve.

The Largest Contributors

We recognize that a financial management policy of self-supporting parts will result in some minor net gains and losses at the end of each year. Due to production requirements, cost changes, and several other factors, self-supporting factories should array themselves relatively equally around the break-even point at the end of each year. After we removed those 58 factories with net gains or losses of less than \$500,000, 13 factories remained, accounting for 36 percent of PIA sales. These 13 factories had such large net

gains or losses that they drove the PIA's total financial results. **Exhibit I-2**, following this page, shows financial results of these 13 factories in fiscal year 1994/95 and indicates each factory's major products and customers.

Of these 13 factories, 4 accounted for \$4.3 million in losses (50 percent of total factory losses) in fiscal year 1994/95. They are the:

- ☐ Dairy at the California Institution for Men
- ☐ Chicken production at Avenal State Prison
- ☐ General fabrication at California State Prison Corcoran
- ☐ Textile mill at R.J. Donovan Correctional Facility.

These losses were subsidized by large net gains at nine factories totaling \$12 million (65 percent of total factory net gains):

- ☐ Specialty printing at California Men's Colony
- ☐ Lens grinding at R.J. Donovan Correctional Facility
- ☐ Metal products at Avenal State Prison
- ☐ License plates at Folsom State Prison
- ☐ Fabric products at California Men's Colony
- ☐ Fabric products at Correctional Training Facility
- ☐ Fabric products at California State Prison Corcoran
- ☐ Shoe factory at California Men's Colony
- ☐ Concrete precast at CSP Solano.

The combined gains and losses from these 13 factories total \$7.7 million in net income, or 78 percent of PIA's fiscal year 1994/95 total net income of \$9.9 million.

The PIA's policy of establishing prices above full costs in order to subsidize weaker operations directly impacts customers and ultimately taxpayers. For example:

- ☐ State agencies which use specialty printing services at the California Men's Colony paid \$1.5 million or 61 percent more than the full cost of the printing factory (including non-production costs). Of this amount, \$470,000 was paid by the CDC
- ☐ The PIA charged Medi-Cal \$783,000 and CDC \$33,000 (or 21 percent) more than the full cost of operating the lens grinding facility at R.J. Donovan Correctional Facility
- ☐ The Department of Motor Vehicles paid \$1.8 million (19 percent) more than the full costs of operating the license plate factory at Folsom State Prison

Major Factory Subsidies
Fiscal Year 1994/95
(\$000s)

Industry	Institution ^(a)	Total Net Income (Loss)	Net Margin (%)	Largest Customer (Percent of Purchases)
1. Dairy	CIM	(\$601)	-16	CDC (64%)
2. Chicken Production	Avenal	(554)	-22	CDC (82%)
3. Specialty Printing	CMC	1,539	61	State Agencies (100%)
4. Lens Grinding	RJD	816	21	Medi-Cal (96%)
5. Metal Products	Avenal	664	15	CDC (72%)
6. License Plates	Folsom	1,772	19	DMV (100%)
7. General Fabrication	Corcoran	(1,690)	-68	State Agencies (98%)
8. Fabric Products	CMC	1,278	24	CDC (77%)
9. Fabric Products	CTF	3,405	42	CDC (77%)
10. Fabric Products	Corcoran	620	19	CDC (77%)
11. Shoe Factory	CMC	756	14	CDC (88%)
12. Textile Mill	RJD	(1,457)	N/A ^(b)	CDC (100%)
13. Concrete Precast	CSP	1,190	31	CDC (99%)
Total for 13 Factories		\$7,738		
Total for PIA		\$9,899		
Percent of PIA Total		78%		

(a) See Exhibit 3 in the Introduction chapter for a key to the institution abbreviations.

(b) The textile mill had negligible sales.

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- ❑ The CDC paid \$5.2 million and other agencies paid \$1.5 million more for metal products, fabrics, and shoes than the PIA's full cost for these products
 - ❑ The CDC paid \$1.2 million (31 percent) for concrete precast products over the PIA's full costs.

In each of these cases, state agencies and taxpayers lost substantial benefits by overpaying for PIA products. For just these nine factories, the CDC paid \$6.9 million more than fully-loaded costs, even though one of the PIA's statutory purposes is "reducing the cost of its (CDC's) operations." Other state agencies contributed an additional \$5.1 million over cost.

Product Impacts

To evaluate self-supporting costs and PIA pricing at the product level, we compared the PIA's actual cost with the PIA's actual prices for six of PIA's largest revenue producing products. Together, these six products represent in excess of \$18 million (12 percent) of the PIA's fiscal year 1994/95 sales.

We determined product costs for fiscal year 1994/95 by obtaining actual historical costs and applying activity-based costing principles. Activity-based costing is a growing industry standard that seeks to allocate overhead and indirect costs directly to products based on the activity that caused the cost. Activity-based costing uses metrics such as warehouse space, production units, machine time, product movements, warehouse transactions, and other more diverse measurements which relate to factors that cause costs to vary. This methodology is different from the PIA's cost allocation approach, which is based entirely on estimates of how many hours inmates spent making the specific product (direct inmate hours).

We used these full-cost estimates to determine what the price should be had the PIA set prices at full self-supporting costs. We then compared these self-supporting prices with the PIA's actual prices. Results of this evaluation are shown in **Exhibit I-3**, following this page.

Of the six products, two had prices below the PIA's full costs, resulting in net losses: the food product and service. As seen in the "Total Paid for Products Over (Under) Cost" column, these losses totaled \$600,000. Prices for the other four products were higher than the PIA's full costs, resulting in substantial net gains totaling \$3.1 million. These product findings clearly support our analysis of factory subsidies presented earlier.

Monopoly Pricing

With few exceptions, the PIA establishes prices in a monopoly environment with a captive customer base. The PIA is able to unilaterally charge prices in excess of their full costs and then use the excess funds to subsidize inmate employment activities that do not pay for themselves.

Comparison of PIA Prices With Full Costs of Producing Selected Products

Products (a)	Actual PIA Price	Potential PIA Price (Estimated Self-Supporting Cost)	PIA Price Over (Under) Estimated Self-Supporting Cost	Total Paid For Products	Total Paid For Products Over (Under) Estimated Self-Supporting Cost	Percentage Paid for Products Over (Under) Estimated Self-Supporting Cost
1. Fabric Product	\$3.15	\$2.32	\$0.83	\$3,569,114	\$940,433	26%
2. Wood Furniture Product	265.68	193.16	72.52	1,143,221	312,054	27%
3. Metal Furniture Product	119.20	66.88	52.32	532,943	233,923	44%
4. Food Product	0.17	0.20	(0.03)	2,893,036	(510,536)	(18%)
5. Metal Product	1.60	1.32	0.28	9,294,000	1,626,450	18%
6. Service	0.27	0.30	(0.03)	811,653	(90,184)	(11%)
Totals				\$18,243,967	\$2,512,140	14%

(a) The PIA claims that its costs are proprietary and requested that we not disclose the names of the specific products selected.

The cost of subsidizing the PIA's inefficient programs is borne within the budgets of each state agency or other customer that pays more for a product than the PIA's true full cost. Further, because there is no "distribution of profits" in the PIA program (all profits are retained for the PIA to use at their discretion), any earnings retained over the amount required by the PIA to be self-supporting are an additional cost borne by state agencies and other PIA customers.

The PIA claims that "profit" and "markups" are part of standard business practices. However, in any business, profits must be distributed back to investors who provided funding for the business. In the PIA's case, there are no stockholders. Rather, taxpayers provided the primary capital for the PIA; yet receive no direct distribution of profits. Further, because taxpayers are the ultimate customers of PIA products, they not only pay for building PIA facilities, they also pay prices that are higher than necessary for some products.

Penal Code Section 2801(c) requires that the PIA be self-supporting. The code does not provide for the PIA to make a "profit." Further, the Penal Code specifies that the PIA should reduce the cost of CDC operations. This mandate coincides with Governor Wilson's recent report on efficiency in state government, in which he states that government must adopt more cost-effective means of delivering services. Absent the Legislature's review of the PIA's budget, the PIA has a responsibility to ensure that each activity it undertakes is the best use of public funds.

Recognizing the absence of any statutes mandating state agencies to pay more than full, self-supporting costs of the PIA, we interpret self-supporting as a required element of all portions of PIA operations; every product, factory, and industry. If the PIA or the CDC believes that a particular product or industry is beneficial for programmatic aspects, but that the product or industry would not be self-supporting, then they should provide support for such benefits and request an appropriation for the incremental costs rather than funding the program through the budgets of its customers.

The PIA is an internal service fund with customers that are primarily state agencies. The PIA must cover all of its costs and provide necessary reserves for new capital programs or other economic needs. Product or service prices should recover these full costs and allow customers to benefit directly from efficiencies.

The PIA currently sets prices and operates factories within a policy framework that acknowledges that some products and factories will subsidize others. The PIA does not currently undergo legislative budget review to describe its pricing policy, major investments, or other uses of public funds. This operating policy, combined with a confusing and contradictory set of legislative goals, inadequate management of financial operations, and lack of budget oversight, has led to the circumstances described above.

The effect of the PIA's policy of setting prices and subsidizing ineffective factories includes:

- ☐ State agencies unknowingly subsidize the inefficiencies of many PIA factories
- ☐ The true cost of inmate employment programs are hidden in the expenditures of other state agencies
- ☐ Policy makers are unable to review and debate the costs and benefits of this inmate work program that is subsidized by taxpayers
- ☐ Taxpayers lose the benefit of efficient PIA operations by paying more than true costs for PIA products.

**More Than One-
Half of PIA's
Products Would
Not Be
Competitive in
Standard State
Procurements**

The PIA provided our project team with prices which other suppliers charge for 18 of 25 products selected for price comparison. Of the 18 products where PIA provided us with prices, we also obtained competition prices on 7 of these products. We obtained up to three competitor prices for each of the remaining seven products. On average, PIA prices are near the midpoint when compared to the range of prices of other suppliers that sell similar products. However, state procurement rules require that state agencies award commodity contracts to the lowest qualifying bid. We found that the PIA's prices, on average, are approximately 7.8 percent higher than the low price quotes provided to us by the PIA and by suppliers we contacted. This difference translates into approximately \$12 million extra being paid by state agencies and other customers over low market prices, during fiscal year 1994/95. If the PIA were required to compete with commercial suppliers for state contracts, it would not be competitive in a wide range of products.

One of the PIA's four new strategies is to provide competitively priced products. Because state customers are a captive market, the PIA has a fiduciary responsibility to ensure that products provided and prices charged do not negatively impact the State. We believe that PIA products should not cost taxpayers more than if they were procured under the State's commodity procurement process.

To gain an understanding of the PIA's price competitiveness, we evaluated a sample of 25 of the PIA's highest revenue producing products. These products, including all sizes and colors, represent 50 percent of total PIA fiscal year 1994/95 sales. For these products, we compared the PIA's current prices with prices of other private sector competitors. The PIA provided us with competitor's prices for 18 products of these 25 products. Where private sector competitors were not available, as with license plates, we compared PIA's prices to those of correctional industry programs in three other large states. We compared PIA's prices with both the "average" of all prices we collected for a product and with the lowest price. In addition, we added 7.5 percent sales tax to competitors' prices, where applicable.

If state agencies procured PIA products through the State's standard procurement process, then the price paid would be the lowest offered by a qualified bidder. We compared the PIA's prices with low market prices and found 13 of PIA's products exceed low market prices, 9 products are below low prices. During fiscal year 1994/95, customers paid 7.8 percent, or \$6 million, more for the products in our sample than if they had been purchased at low market prices. When extrapolated to total 1994/95 sales, customers paid an estimated \$12 million more than low market prices.

The PIA's prices are not competitive when evaluated under existing State procurement regulations. This fact held true when we determined either the number of products or the total cost to PIA customers.

One reason why PIA prices are higher than low competitive market prices is that the PIA is not required or mandated to make its prices competitive. This lack of policy guidance allows the PIA to set prices above commodity market prices. Also, the PIA does not know what the actual cost of products are because of weaknesses in their cost accounting process that we explain in Chapter 2 of this report.

The PIA's total revenue requirements must be high enough to fund its inefficient factories and its policy of retaining a residual net income. In fiscal year 1994/95, the PIA charged an average of 17 percent over self-supporting costs for products from its profitable factories. For the same year average product prices across PIA industries were 7.8 percent over low market. It appears that, had the PIA not had the burden of subsidizing weak factories and had adjusted its policy for retaining income, the PIA could have reduced prices to below the lowest price offered by competitors. Doing so, the PIA could be competitive in the State's procurement environment.

**The PIA Does Not
Appear to Reduce
the Costs of
Operating a Prison**

The PIA and the CDC believe that security, education, and vocational instruction costs are lower at institutions where the PIA is present. We have determined that this supposition is not true. Based on analysis we performed, security, education, and vocational instruction costs are about the same at correctional institutions where the PIA is present.

The CDC and the PIA believe that employing inmates in PIA industries reduces costs for correctional officers and teachers because:

- ☐ While working in a PIA factory, inmates are less likely to cause trouble because they don't want to lose their jobs and related privileges. Accordingly, fewer correctional officers are needed
- ☐ Fewer education and vocational instructors are needed at institutions where the PIA is present because employed inmates are generally excluded from vocational and education programs.

From the CDC's annual operating budget, we determined the actual total personnel years and salaries for correctional officers, teachers, and vocational instructors.⁸ This information is reported for each CDC institution. The CDC also provided us with the number of inmates housed at each institution, and the mix of these inmates by security level, as of June 30, 1995. We evaluated this cost and inmate population data in a number of ways, including comparing prisons with and without the PIA that have similar mixes of inmates by security level.

With each comparison, we came to the same conclusion. There is no measurable difference in the security or education costs between prisons with the PIA and those without the PIA. Overall, total direct salaries for correctional officers, teachers, and vocational instructors, when measured as dollars per inmate housed, is about the same for the 23 CDC institutions with PIA facilities versus the 7 institutions without the PIA.

Table I-5, below, shows how costs compare between PIA and non-PIA institutions. Although the table shows that total costs per inmate for prisons with PIA is greater than those without, there are many other significant factors that influence these costs. Therefore, we cannot conclude that these costs are either greater or lower at institutions with PIA.

Table I-5
Security, Education, and Vocational Costs Per Inmate
Fiscal Year 1994/95

Position	Cost per Inmate	
	PIA	Non-PIA
Correctional Officer	\$7,527	\$7,420
Teachers	315	293
Vocational Instructor	235	296
Total	\$8,077	\$8,009

Additional information provided by the PIA indicates that not only are the State's costs of guarding and training inmates not lower with a PIA operation, but that costs may in fact be higher. The PIA estimates that in 1995 it spent the equivalent of 66 personnel years performing work that does not occur in private industry and which is a subsidy to the CDC. This work includes filling out two different CDC time sheets each day for approximately 7,000 inmates (in addition to a third PIA time sheet), and conducting tool searches, standing counts, and factory and pat searches. Assuming an average direct salary of

⁸ The fiscal year 1996/97 Governor's Budget contains actual CDC expenditures for fiscal year 1994/95.

\$44,300 for PIA factory personnel, plus 25 percent fringe benefits, these activities may in fact increase costs by over \$500 per inmate.

**Costs Avoided
Through the PIA
Are Not Unique**

The PIA and the CDC stated that the PIA saves the State money in two ways: (1) by providing expanded opportunities for inmates to earn time off their sentences, and (2) by providing an alternative to vocational training programs that are more costly. There is no consensus nationally or within the State of California government on the costs and benefits of early release of inmates. In addition, PIA employment is not a "no cost" programmatic alternative as the PIA claims, and vocational training is not the only alternative programming available to PIA inmates.

Sentence Reduction Credit

Inmates participating in programs such as academic education, vocational training, CDC institutional support work assignments, or the PIA receive credit for time off of their sentence for time participating in these programs. As of June 30, 1995, 82 percent (71,000) of eligible inmates were participating in such sentence reduction programs. Of these, 7,012 were employed by the PIA.

Inmates working in the PIA receive one day off of their sentence for each day worked. For example, if a PIA inmate works 6 hours in a day, that inmate receives 24 hours off his or her sentence, up to certain sentence reduction caps. The PIA estimates that from fiscal year 1984/85 through fiscal year 1994/95, it provided a cumulative \$169 million in "cost avoidance" to the CDC through sentence reduction credits. The PIA estimated the dollar value of the cost avoidance by calculating the number of years of sentence reduction earned through PIA employment and multiplying by the average annual cost to incarcerate an inmate. For fiscal year 1994/95, the PIA estimates that the CDC's average annual cost of incarceration is \$20,927 per inmate. This calculation is based upon a headcount at June 30 each year, and assumes that each inmate working on that day would have earned a full year's worth of sentence reduction credits.⁹

Sentence reduction credits are not a significant or unique benefit of the PIA program. Institutional support services account for the vast majority of inmates in a sentence reduction program, with 58 percent of all inmates in sentence reduction programs. Academic education and vocational instruction account for approximately 16 percent each of those inmates in sentence reduction programs. In addition, even those eligible inmates who are not actually participating in any sentence reduction program receive sentence reduction credits while waiting to participate in a program. Therefore, although the PIA claims \$169 million of cost avoidance through participation in the PIA, other programs provide the same "benefit."

⁹ The 7,012 inmates employed by the PIA is determined as the headcount on June 30, 1995. Based on actual numbers of hours worked by, and paid to inmates, the full-time equivalent employment during fiscal year 1994/95 ranged from 4,404 to 5,872.

The question of whether early release programs generate savings or costs to the taxpayer and society in general is very controversial. For example, recent research on the effect of prison population size on crime rates shows that for each one-prisoner reduction induced by prison overcrowding litigation, the total number of crimes committed increases by approximately 15 per year. This research goes on to estimate that the social benefits from eliminating these additional crimes may be up to 50 percent more than the annual per-prisoner costs of incarceration.¹⁰ It may, in fact, cost society less during the first 12 months of release to keep inmates incarcerated, rather than to release them.

At the same time that the PIA and the CDC claim this budgetary “cost avoidance” to the CDC, the Wilson Administration is stating that spending \$1 to incarcerate a “three strikes” felon saves society almost \$4 from crimes not committed by these career criminals.¹¹ However, there are significant differences between budgetary savings in CDC costs due to a reduction in incarcerations, and generation of public benefits due to reductions in crime.

We realize that public policy cost/benefit calculations, such as those cited above, are inherently uncertain, given the difficulty in quantifying these types of social issues. However, there is little empirical evidence to verify or disprove the sentence reduction benefits of the PIA program, especially from the taxpayers perspective.

Vocational Instruction

The PIA stated that the CDC is under a statutory mandate to employ at least 60 percent of the eligible inmates in 15 prisons built after 1985 in either PIA or vocational training. Therefore, according to the PIA, every inmate employed by the PIA is one less inmate that needs to be included in a vocational training program at an estimated annual cost of \$4,434 per inmate. As a result, the PIA assumes that for every inmate employed by the PIA at these institutions, it avoids a cost of \$4,434 per year. However, we do not believe the CDC is under such a mandate. Moreover, the CDC is not meeting the mandate, whether real or perceived.

As support for the mandate, the PIA pointed to Chapter 1, Statutes of 1982 (Assembly Bill 1403), which states that it is the Legislature’s intent that all able-bodied prisoners be directed to work, inasmuch as the performance of productive work is the most appropriate method of instilling in prisoners the values of law-abiding and cooperative society and will improve the possibility of their reintegration into that society.

¹⁰ The National Bureau of Economic Research, Steven Levitt, *The Effect of Prison Population Size On Crime Rates: Evidence From Prison Overcrowding Litigation*, NBER Working Paper Number 5119.

¹¹ California Department of Corrections, Office of Planning and Research, *Three Strikes, You’re Out: Two Years Later*, Undated (released March 1996).

The PIA also referenced Chapter 326, Statutes of 1982 (Assembly Bill 21), which happens to be the budget act for that year. The budget for the CDC included control language regarding the construction of the Southern Maximum Security Complex at Tehachapi. Specifically, this control language stated that prior to the allocation of construction funds for the prison, the prison had to be redesigned to allow space to enable 60 percent of the inmate population to be employed by Correctional Industries (PIA) or to participate in vocational training. Language similar to the preceding was added to Section 2048.7 of the Penal Code in 1985.

Based upon the preceding legislation, the CDC and/or the PIA interpreted that they were required to employ 60 percent of the inmates in institutions built after 1985. The CDC then established a policy that 70 percent of the 60 percent requirement be met by the PIA; therefore, the PIA was expected to employ 42 percent ($0.7 \times 0.6 = 0.42$) of the inmates in subsequent new institutions. Vocational instruction, academic education, and support services were expected to involve respectively 18, 15, and 25 percent of inmates housed.¹²

However, nothing in any of the legislation cited by the PIA refer to any institution other than Tehachapi. Therefore, we conclude that, except for Tehachapi, there is no merit to the PIA's contention that every inmate employed by PIA is, by definition, one less inmate who would have to participate in vocational training at an additional cost to the State.

In response to our concerns about the applicability of the governing statutes, the PIA calculated the "cost avoidance" for Tehachapi only. The PIA estimates that from fiscal year 1984/85 through fiscal year 1994/95, it has provided a cumulative \$18 million in "cost avoidance" to the CDC by programming of Tehachapi inmates in prison industries rather than in vocational instruction. This calculation is based upon a headcount at June 30 each year, and assumes that each inmate working on that day would have earned a full year's worth of avoided costs.

Another concern we have is that the CDC currently is programming less than 60 percent of inmates in these institutions in either vocational training or the PIA. According to the PIA, 10,202 inmates were enrolled in vocational training during fiscal year 1994/95, or 8.4 percent of CDC's population. The PIA employed an additional 5.8 percent of the CDC's institutional population. Therefore, the PIA's contention that each job in the PIA would necessarily result in costs avoided in vocational training loses much of its effect.

¹² Department of Corrections Memorandum, April 18, 1985, and Prison Industry Issue Memo Number 86-09, reviewed by General Manager David H. Craig (undated).

Finally, we do not believe that the only programming alternative to the PIA inmates is the expensive vocational instruction program. Institutional support is much less expensive. Again, the PIA assumes no cost of employing an inmate because it assumes it is "self funded," and compares a "no-cost" PIA alternative with one of the most expensive programming alternatives, vocational training.

Chapter 2

The Prison Industry Authority Is Unable to Manage Costs and Profitability of Its Products and Factories

A vital function of the Prison Industry Authority is to accumulate, record, analyze, and monitor the costs of producing its products. The PIA must accurately determine the cost of making products and manage these costs in order to determine the efficiency and effectiveness of its diverse manufacturing operations, establish fair and justifiable prices, and provide products to state agencies that are cost-effective. The system for accumulating costs must allow management to monitor all of the PIA as well as individual products, factories, and industries. Managing product and factory costs is key to providing strategic direction to the entire PIA organization, as well as to monitoring the PIA's performance against budget and other operating standards.

Based upon our review, we found that the PIA: (1) does not have accurate product cost information and is unable to manage costs and profitability on a product basis, (2) does not have accurate factory cost information until after year-end and is unable to effectively manage factory costs, (3) does not follow common industry practices for cost accounting related to developing standards, allocating indirect costs and analyzing variances between estimated and actual production costs, and (4) spreads cost accounting responsibilities and duties throughout the organization, and does not have sufficient cost accounting training or experience for an organization of their size and complexity. As a result, product costs are inaccurate and can not be used as a meaningful management tool, factory and inventory costs are not available during the year to manage the operations effectively, and the PIA does not have the expertise to implement an effective cost accounting system.

The PIA Is Unable to Manage Costs and Profitability of Its Products and Factories

The PIA does not maintain accurate unit costs for its products, making it difficult to manage its business, identify or manage product profitability, identify products that are losing money, establish fair and adequate prices, or develop plans to grow, reduce, or discontinue products. Inaccurate product costs also distort inventory and cost reporting at the factory level making it difficult or impossible to manage factory profitability. The PIA does not use product cost data in any meaningful financial management activities. Current profitability reports are summarized for each factory; however, the PIA does not regularly evaluate profitable and unprofitable products within those factories.

Without accurate information on the expected and actual cost of each product manufactured or service delivered, it is difficult for the PIA to:

- ☐ Prepare useful or accurate interim financial reports
- ☐ Prepare useful or accurate budget-to-actual reports for managers of manufacturing operations
- ☐ Develop realistic product strategies, plans, and budgets
- ☐ Monitor ongoing activities and identify products or operations which are successful
- ☐ Provide an early warning system of problem areas
- ☐ Develop measurable criteria for managing improvements
- ☐ Project and manage product profitability
- ☐ Set prices that are fair to customers and recover the full cost of the product
- ☐ Evaluate new product developmental plans
- ☐ Develop plans to grow, reduce, or discontinue products.

Without accurate product cost information, the PIA must rely on factory or PIA-wide information to measure effectiveness and to support strategic decisions. However, the actual causes of strong or poor performance are hidden from view and difficult to identify and act upon. Inaccurate product costs also lead to misstatement of inventory and cost accounts until year-end audit adjustments are determined. Product level cost information could be readily available through the appropriate implementation and use of the Manufacturing and Accounting Planning System (MAPS), which is being implemented by the PIA. However, the data stored in MAPS are neither accurate nor reliable.

Accurate product cost information is a cornerstone of management information in substantially all manufacturing and service industries. Manufacturing companies typically use "standard" (or estimated) costs as a means for valuing products. Organizations use standards as both a measurement yardstick, much like a budget, and as a best estimate for product costs to record inventory and production transactions. Continual comparison of actual to standard costs (variance analysis) is necessary to monitor progress and identify as early as possible any situation requiring attention. Accurate standards are critical to the ability to manage product costs and profitability, and to maintain accurate financial information.

Inaccurate Product Costs

To determine the relative accuracy of PIA's product level standard cost information, we compared each factory's actual cost of goods sold with the standard cost of goods sold established by the PIA. Actual cost of goods sold is actual inmate labor costs, raw materials, and overhead costs incurred by a factory to manufacture its products. The standard cost of goods sold is the PIA's estimate of the inmate labor costs, raw materials, and overhead costs required to manufacture the factory's products. The difference equals the

amount by which the total costs applied to products (for valuing inventory) differs from actual costs. The PIA establishes standards only for manufactured products; there are no standard costs for service and agricultural industries.

During fiscal year 1994/95, the PIA's standard cost of manufactured goods sold totaled \$55.5 million, while actual costs were \$69.0 million. The PIA underestimated the cost of all manufactured products by \$13.5 million, or nearly 20 percent. Results were similar in fiscal year 1993/94, when the PIA underestimated product costs by \$11.9 million, or 19 percent. Overall, this means that the PIA underestimated costs for planning purposes and understated inventory values throughout the year by a composite of 20 percent for these factories.

Importantly, the 20 percent total variance in cost of goods sold is a net figure made up of a number of offsetting under and overestimations. Both conditions lead to inaccurate accumulation of cost of goods sold and inventory balances during the year, and also leads to improper management, pricing, and operating decisions.

Exhibit II-1, following this page, compares standard and actual cost of goods sold for each of PIA's manufacturing factories during fiscal year 1994/95. This information is summarized in **Table II-1**. Overall, of PIA's 34 manufacturing factories, percentage differences between total standard and actual costs were as follows:

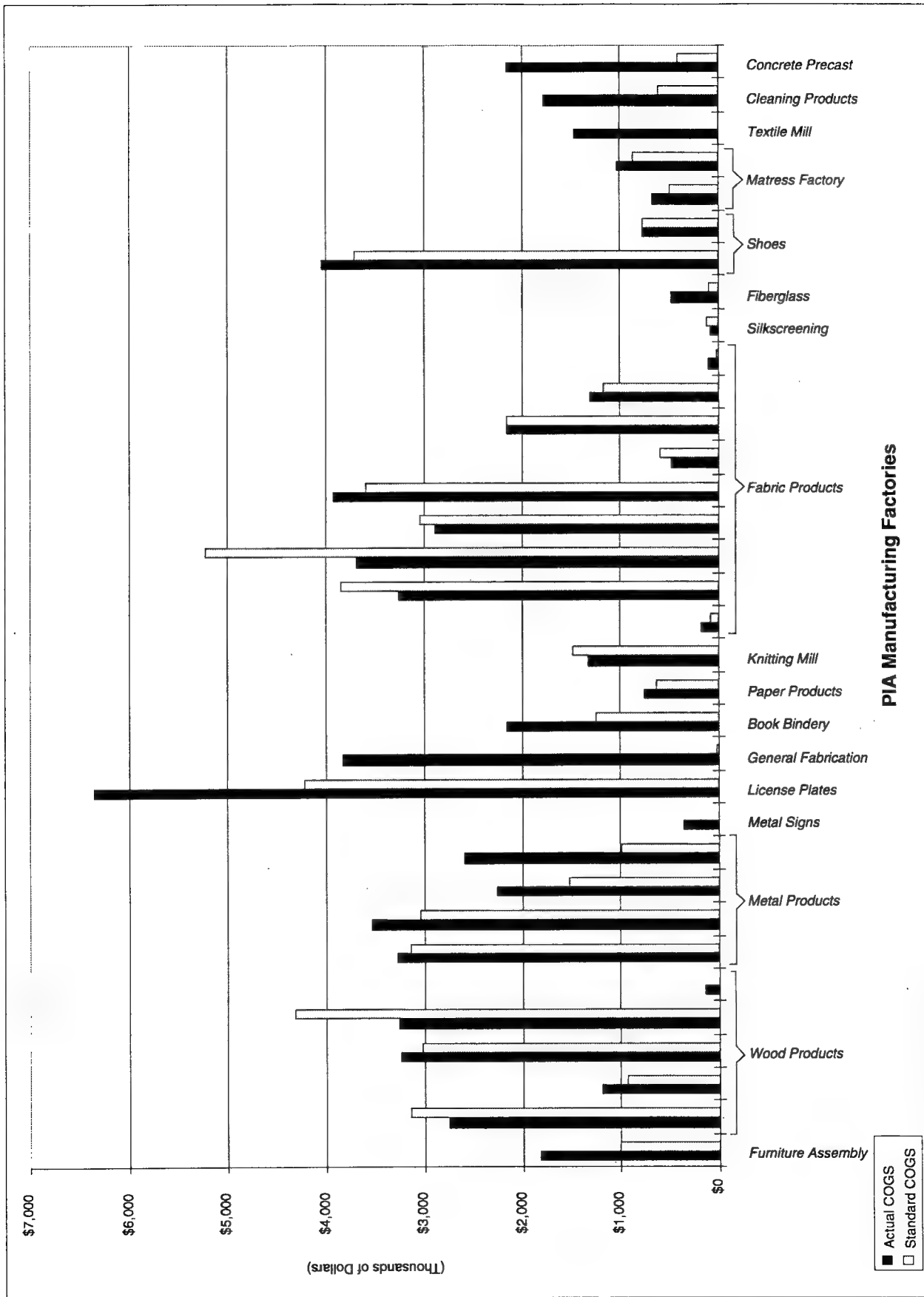
Table II-1
Accuracy of Total Standard Costs

Percent Difference from Total Actual Costs	Number of Factories
Plus or minus less than 20%	14
Plus or minus 20% to 40%	6
Plus or minus 40% to 60%	5
Plus or minus 60% to 80%	5
Plus or minus 80% or greater	4
Total	34

Source: Prison Industry Authority

Nearly 60 percent of the PIA's factories had differences in excess of 20 percent between what they recorded as their product costs in inventory and what product costs actually were. Considering that the PIA's operating income was just over six percent, this level of imprecision in product costing makes this information misleading for managing product operations and profitability.

Comparison of Actual and Standard Costs of Goods Sold (COGS) ^(a) Fiscal Year 1994/95



(a) Solid bars represent total actual costs of goods sold (COGS) during fiscal year 1994/95, as determined by the PIA following the financial audit completed November 1995. White bars represent estimated (or standard) costs of goods sold which the PIA assumed during fiscal year 1994/95. Industries along the horizontal axis are listed in the order of an identifying number used by the PIA.

Inaccurate Factory Costs

The PIA's monthly financial reports, which are used to manage and control operations, are inaccurate, incomplete, and late. The PIA has such significant variances between its standard costs (used to value inventory) and actual costs that it reports distorted factory profitability throughout the year. At the end of each fiscal year, the PIA relies on external financial auditors to value inventory at actual cost and to develop adjustments that moves costs between inventory and cost of goods sold. Prior to year-end adjustments, these misstatements of inventory and costs of goods sold significantly impact the accuracy of any management reports of ongoing costs and profitability throughout the year.

In addition to being inaccurate, PIA management reports also are incomplete. Monthly management reports do not show expenditures on raw materials, one of PIA's largest outlays.¹ As a result, factory and product managers do not have information to manage and control these costs. The reason the PIA cannot provide this information to its managers is that the PIA has inaccurate standard costs and the PIA does not fully understand cost accounting. As a result, it is very difficult for the PIA to extract the information needed from MAPS, which stores the information. Those who need to know expenditures on raw materials are unable to get the information. The PIA's Comptroller has requested the PIA Data Management and Information Systems division to write special programs to provide this information, but the information has not yet been produced.

PIA management reports also are late. The PIA takes a minimum of six weeks after the end of a month to generate management reports for that month. Because these reports are at least six weeks old, their value to management is diminished because the reports lose their effectiveness as a tool to manage and control costs. For example, decisions over cost control may be inaccurate and ineffective because costs may have changed over this period.

When manufacturing operations use standard costing methodologies, they typically cost products using standard rates and application factors such as labor hours or machine time. The resulting standard product costs are used as a basis for recording accounting transactions as goods move through the work-in-process and finished goods inventory, and into the account that accumulates the cost of goods sold to customers. Because inventory is an asset account and cost of goods sold is an operating account, significant variances in standards will skew the amounts recorded in these asset and cost accounts, and distort cost and profitability reporting. Accurate product cost standards and ongoing variance analysis is critical for accurate financial information during the year.

¹ Raw materials include such items as cotton, fabrics, wood, metal, aluminum sheeting (for license plates), optical lenses, chemicals (for detergents), milk cartons, and beef carcasses.

To evaluate the PIA's misstatement of inventory, we reviewed actual inventory adjustments made at the end of the fiscal year and compared these to year-end operating profitability at each of PIA's factories. For cases in which year-end adjustments had a material impact on a factory's profitability, any profitability reports or profitability planning based on those reports were based on inaccurate information.

Overall, the PIA had a very small net inventory adjustment totaling just \$7,000 at fiscal year-end 1994/95. However, this net adjustment consisted of a large number of positive and negative adjustments at each of PIA's 34 manufacturing factories, resulting in the small overall difference. **Exhibit II-2**, following this page, illustrates how PIA's year-end adjustment of inventory changed the final operating profit for each manufacturing factory. This information is summarized in **Table II-2**, below.

Table II-2
Year-End Inventory Adjustments
At Each Manufacturing Factory

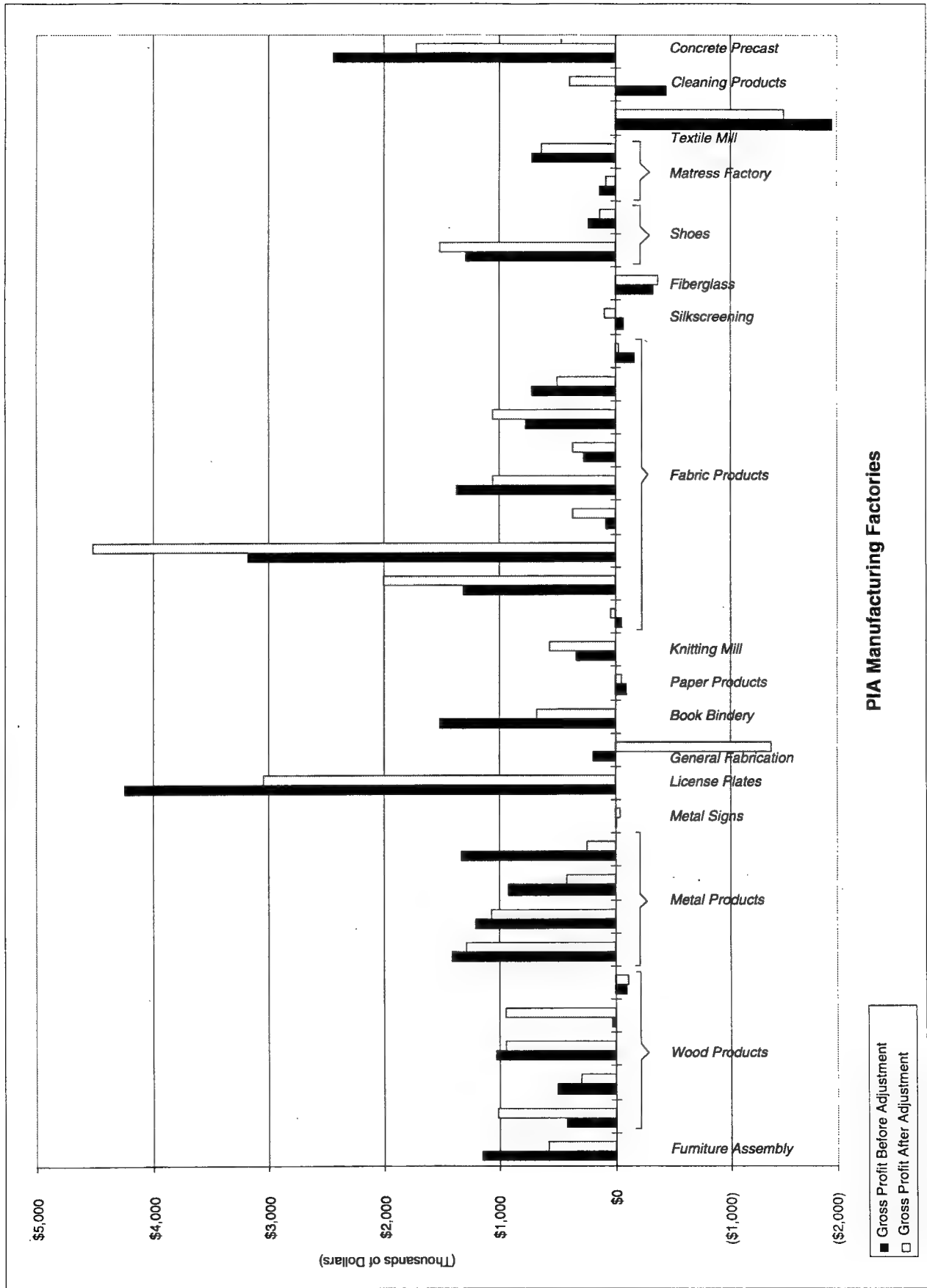
Adjustment Made at Year-End As a Percent of Gross Profit	Number of Factories
Plus or minus 20% or less	7
Plus or minus 20% to 40%	7
Plus or minus 40% to 60%	5
Plus or minus 60% to 80%	5
Plus or minus 80% to 100%	10
Total	34

Source: Prison Industry Authority

Of the 34 PIA factories, 79 percent had more than a 20 percent adjustment made to their year-end gross profit because the value of the factory's inventory had to be adjusted (either up or down) at year-end. Almost 60 percent of the PIA's factories had a change of greater than 40 percent. These adjustments mean that, during the year, PIA management at most factories did not have reliable profitability and cost information with which to manage operations.

The inaccurate standard costs are the result of imprecise overhead cost allocations caused by weaknesses in the PIA's implementation and control of its cost accounting process and organization.

Factory Gross Profit Before and After Year-End Inventory Adjustments (a)
Fiscal Year 1994/95



(a) Industries along the horizontal axis are listed in the order of an identifying number used by the PIA.

Imprecise Overhead Allocation Methodology

The PIA accumulates factory level costs in three primary cost categories:

- ☐ Direct labor -- Direct labor is inmate labor which is applied directly to products through standard production hours and standard rates for each product.
- ☐ Direct materials -- Raw materials and manufactured components used to make a product. Costs for these are applied to products based on the PIA's assumed quantity of each material and component used and the standard cost per unit of these materials.
- ☐ Overhead -- Overhead includes all other costs of the factory and PIA administrative offices at the institution. Included in overhead are the salaries and benefits of 614 PIA factory and administrative employees at the institution, depreciation, rents, utilities, maintenance, repairs, and other costs of the factory and PIA administrative offices at the institution. Overhead is applied to products using a single overhead rate for each manufacturing cost center based on the "standard" inmate labor hours required to manufacture each product.

Because inmate labor costs are low, overhead represents 50 percent of product costs, as shown in **Table II-3**, below.

Table II-3
Components of Actual Cost of Goods Sold
Fiscal Year 1994/95
(\$000s)

Component	Cost of Goods Sold	Percentage
Direct Inmate Labor	\$1,750	3%
Direct Materials	39,530	57%
Overhead	34,223	50%
Change in Inventory ^(a)	(6,441)	(9%)
Total	\$69,062	100%

(a) Represents the costs remaining in inventory that are not related to goods sold during the year.

Source: Prison Industry Authority

The PIA allocated overhead costs to each PIA product based on a standard rate developed for each manufacturing cost center. This rate is based on the prior year's actual costs and estimated direct inmate labor hours. After the financial audit each year, actual overhead costs for each factory are accumulated for the prior fiscal year. The PIA then develops estimates of direct inmate labor hours for the prior fiscal year, based on an estimated percentage split of total actual inmate hours into direct and indirect hours.² The PIA determines an "overhead rate" (dollars per hour) by dividing actual overhead costs by estimated direct inmate labor hours. This new rate then is used to update the Standard Cost File on January 1 following the end of the prior fiscal year. The PIA uses this single rate to apply overhead costs to all products within all factories within a single manufacturing cost center for the next calendar year.

Conceptually, the PIA adjusts overhead standard rates for each upcoming calendar year to the rate that should have been used in the prior fiscal year. However, this approach has several shortcomings:

- ☐ The standard overhead rate is derived from an estimate of historical direct inmate labor hours which, based on our review of actual and standard labor hours provided by the PIA, varies widely in accuracy by factory and institution
- ☐ The PIA's using historical labor hours instead of expected labor hours based on current production plans does not compensate for expected changes in production volumes
- ☐ A single rate is used for the upcoming calendar year, and this rate is based on costs that are 6 to 18 months old. The PIA does not make any changes to overhead costs during the entire calendar year, even though the basis for allocating them may change
- ☐ The PIA does not perform a detailed variance analysis to determine why overhead rates change so dramatically over the year. Instead, the PIA lets these overhead rates change automatically without evaluating the underlying causes for the variance or need for change, and without fixing the problem.

As a result, the PIA estimates 50 percent of its product costs using cost information that is up to 18 months old, and based on imprecise estimates of direct inmate labor hours. This method underestimates overall product costs by 20 percent on a composite basis, and it is even more inaccurate for many individual products. Due to these significant inaccuracies, the PIA cannot use product costs reported by MAPS as a meaningful management tool in operations, pricing, or product planning.

² The estimated split of inmate labor hours between direct and indirect is developed by central office fiscal staff and confirmed by factory managers.

**The PIA's Cost
Accounting
Process Is
Inadequate and
Does Not
Encompass
Common Industry
Practices**

Overall, the cost accounting process at PIA is poorly developed. The PIA does not have a documented cost accounting methodology that identifies procedures and assigns responsibility to an individual to maintain accurate standards, review allocation procedures, and conduct variance analysis. Cost accounting is largely related to the capabilities of the MAPS system: responsibilities for each element of the system are assigned and procedures for operating the system are the defacto cost accounting procedures. The results are inaccurate product cost information and the inability to determine the reasons for these inaccuracies.

Standard cost accounting methodologies commonly used by industry encompass the following:

- ❑ **Development and control of standards** – Standards for determining how much labor, material, and overhead costs are necessary to produce a product are carefully developed, and typically are based on historical costs, planned costs, production plans, actual and estimated prices, and an in-depth review of each factory operation and overhead requirement. Management considers consistency across operations and factories where appropriate. Once developed, standards are changed in a managed and controlled manner based on regularly documented variance analysis or changes in production or costs.
- ❑ **Allocation of indirect and overhead costs based on the activity causing the cost** -- Allocation of indirect and overhead costs to a product must carefully consider what causes, or “drives” these costs. For example, allocating a share of PIA’s warehouse rent to a product based on direct labor hours for the product may significantly skew product costs unless the time required to make the product is related directly to how much space is needed to store it. Determining the cause or driver of each indirect and overhead cost is the foundation for strong cost allocation.
- ❑ **Complete and timely variance analysis** -- The key to using standards effectively is ongoing review and continual improvement of standards to reflect ongoing and changing operations. This variance analysis must be performed on a regular and thorough basis and be well documented as to procedures and actions that result from the analysis.

Currently, PIA factory managers and analysts develop and input direct labor hour standards and raw materials usage standards into standard cost tables. The PIA maintains these tables on MAPS. These labor and material standards can be changed at any time in the tables. However, the PIA uses these tables only once per year to actually update the master “cost file” maintained on MAPS and to change standard costs. This update takes effect January 1 of

each year. The PIA does not review these updates for consistency between similar operations or factories, and it does not have a documented control procedure to review changes against source documents.

The PIA allocates all indirect (or overhead) costs using a single overhead rate for each institution based on standard direct inmate labor hours. This approach allocates 50 percent of the PIA's manufacturing costs based on a single measure, direct inmate labor hours. Although direct inmate labor hours are a valid basis for allocating some indirect costs to a product, the PIA has not performed a detailed review of all indirect cost items to determine if: (1) certain overhead costs can be charged directly to products, or (2) whether an alternative exists to better allocate overhead cost in order to provide more reliable product costing. The PIA's significant overhead costs are:

- ☐ Equipment and improvements depreciation
- ☐ Supervisory salaries and other personnel costs
- ☐ Rent
- ☐ Utilities
- ☐ Tools
- ☐ Freight for purchases
- ☐ Maintenance and repairs
- ☐ Professional services
- ☐ Sales taxes paid
- ☐ Discounts taken.

The PIA does not perform a detailed variance analysis of standards. Rather, the PIA performs a single analysis of the overhead rate nearly six months after the close of the fiscal year in which accurate standards were needed, then calculates what the actual rate should have been for the prior fiscal year. The PIA then uses this new rate for the upcoming calendar year. The PIA does not review individual components of what causes the variances between standards and actual costs (e.g., price changes, usage changes). Finally, the PIA has not developed plans to respond to positive and negative variances if they are found.

The effects of the PIA's lack of cost accounting procedure and methodology is inaccurate product cost information and the inability to determine the reasons for these inaccuracies. PIA management is left without important tools to manage its businesses, and, in many cases, customers must pay for poorly performing products.

**The PIA Has Not
Recognized the
Importance of
Reliable and
Accurate Cost
Information to
Managing Its
Complex
Operations**

Cost accounting duties are spread throughout the PIA organization and no single individual or organization is accountable for accurate cost accounting information. Further, PIA staff do not have sufficient cost accounting training or experience to manage an operation of PIA's size and complexity. Until the PIA focuses attention of experienced staff on cost accounting, problems with inaccurate product and factory costs will continue.

At the PIA, cost accounting responsibilities are spread throughout the organization based on their interaction with the MAPS system. No one is responsible for the overall accuracy of standard cost information. Further, the PIA must comply with civil service requirements for hiring personnel; substantially all fiscal and systems staff came from other areas of government, and have little, if any, cost accounting experience outside that obtained at the PIA. There is only one Certified Public Accountant among the nearly 48 people working in PIA's Fiscal Services and Materials Management branch, which provides financial management for PIA's \$152 million operation.

The PIA has not recognized that accurate cost accounting information is critical to its operations and has not applied the necessary organizational or personnel resources to this area. Currently, cost accounting at the PIA is very decentralized, and there are no major users of this information. From a personnel perspective, the PIA is constrained in its ability to hire staff with extensive cost accounting experience because currently there is generally little or no such expertise within the civil service system.

Without the organizational directive or experience to identify needed changes, the PIA does not have the direction or resources to implement an effective cost accounting system. Until trained and experienced staff implement such a system, problems with inaccurate product and factory costs will continue.

Chapter 3

The Prison Industry Authority Should Improve Its Operational and Financial Management Activities

The Prison Industry Authority manages a complex, multi-industry business, and operates 73 separate manufacturing, service, and agricultural facilities. In this Chapter we discuss why we believe that the PIA has not effectively managed this complex business. We conclude that the PIA does not effectively plan for its various functions, including strategic planning, production planning, order fulfillment, budgeting, cost accounting, investment analysis, and cash management. As a result, customers are paying unnecessary costs, and large investments of State funds in PIA facilities are not adequately protected.

The PIA also has difficulty delivering its products, the major complaint of its customers. The PIA takes approximately 150 days to deliver products. To reduce long delivery times, the PIA recently embarked on an expensive change in production strategy. This shift from making products after a customer places an order ("make-to-order") to making and building an inventory of products in advance of customer orders ("make-to-stock") is an expensive solution to delivery problems.

We compared the PIA's performance with correctional industries operated by three other large states and the federal government. We found that the PIA compared favorably with these other programs, on several measures, including percentage of inmates employed, sales per free staff, gross profits, days of inventory on-hand, and management of accounts receivable. The PIA's net income reported on financial statements is the highest among the four other programs. Neither the PIA nor these other four programs report significant subsidies in the financial statements from capital contributed by the State or from low monthly rental charges for facilities.

PIA Inventory Levels Are Excessive

The PIA maintains inventory levels that are, in some industries, several times higher than comparable levels maintained by the private sector. Because inventory levels are high, the PIA incurred unnecessary carrying costs of approximately \$2.7 million in fiscal year 1994/95. These costs include the warehouse space needed for storage, depreciation, interest on funds invested in inventory, and obsolescence. Excessive inventory has been an ongoing and acute problem with the PIA for at least six years.

Though still high, the PIA has reduced inventory levels over the last six years. For example, work-in-process inventory was reduced from \$8.9 million on sales of \$97 million during fiscal year 1988/89 to \$8.2 million on sales of \$152 million in fiscal year 1994/95. Also, the number of days in inventory for the PIA's largest industries has declined from 192 days in fiscal year 1988/89 to 123 days in fiscal year 1994/95.

The twelve top grossing PIA manufacturing industries accounted for approximately 84 percent of PIA's inventory at June 30, 1995. We determined inventory for each of these 12 industries and then compared it with median inventory levels found in the private sector for comparable industries. From this comparison, we estimate excess levels of inventory and associated carrying costs were estimated. The total carrying cost of inventory was estimated to be 17 percent of the value of on-hand inventory.

The PIA's twelve major manufacturing industries, in order of fiscal year 1994/95 sales, are:

- | | |
|--------------------|----------------------|
| 1. Fabric products | 7. Optical |
| 2. Metal products | 8. Shoes |
| 3. Wood products | 9. Printing |
| 4. Dairy | 10. Concrete precast |
| 5. License plates | 11. Egg products |
| 6. Meat processing | 12. Bindery. |

The cost of goods sold for these industries during fiscal year 1994/95 was approximately \$87.1 million. During the same year, the average on-hand inventory value for these industries was approximately \$29.8 million. Therefore, the "inventory turnover ratio" was 2.9 (\$87.1 million divided by \$29.8 million). This measure indicates how effective the PIA was at managing its inventory (a higher number is better). The 2.9 turnover indicates that improvement is needed.

A second measure of inventory management is the number of days that factories could continue to produce using only the on-hand inventory without replenishment. This number, days of inventory on-hand, is determined by dividing 360 days (one year) by the inventory turnover ratio. In this case, dividing 360 days by a 2.9 turnover ratio yields 123 days of inventory on-hand. **Table III-1**, on the next page, lists the costs of goods sold, the inventory turnover ratio, and the days of inventory on-hand for each of the PIA's twelve largest industries.

Table III-1
PIA Inventory Turnover and Days On-Hand

Industry	Fiscal Year 1994/95 Costs of Goods Sold (\$000)	Average Inventory Turnover Ratio	Average Days of Inventory On-Hand
Fabric Products	\$ 17,896	1.9	189
Metal Products	11,642	2.5	144
Wood Products	10,453	1.8	200
Dairy	11,616	12.3	29
License Plates	6,348	2.4	150
Meat Processing	7,561	12.7	28
Optical	6,442	6.2	58
Shoes	4,827	2.0	180
Printing	2,981	5.6	64
Concrete Precast	2,147	12.6	29
Egg Products	3,017	44.7	8
Bindery	2,141	1.2	300

Table III-2, on the next page, compares PIA inventory levels with levels typically found in the private sector. The comparable inventory medians shown were developed by Robert Morris Associates (RMA) for use in comparing a firm's individual performance with the industry median.¹ The RMA arranged industry performance measures in quartiles, and provided a median (one-half of industries surveyed have averages above the median, and one-half have averages below the median).

¹ Source: *RMA Annual Statement Studies 1995*, Robert Morris Associates, for fiscal year ending 3/31/95. The RMA report provides comparative financial data for thousands of companies in over 100 industries. For this PIA report, we obtained historical median performance for 2,625 companies in 19 industries, including clothing, metal, wood, dairy, meat processing, optical, shoes, printing, concrete, and paper industries.

Table III-2
PIA Excess Days of Inventory On-Hand

Industry	Average Days of Inventory On-Hand	Private Industry Median Days On-Hand	Excess Days of Inventory On-Hand	Percentage of Inventory in Excess
Fabric Products	189	116	73	39%
Metal Products	144	51	93	65
Wood Products	200	46	154	77
Dairy	29	20	9	31
License Plates	150	42	108	72
Meat Processing	28	16	12	73
Optical	58	90	(32)	(55)
Shoes	180	95	85	47
Printing	64	26	38	59
Concrete Precast	29	40	(11)	(38)
Egg Products ^(a)	8	N/A	N/A	N/A
Bindery	300	17	283	94

(a) There is no private industry benchmark for egg products.

Based on these comparisons, the PIA maintains excessive inventory. The average inventory on-hand during fiscal year 1994/95 was approximately \$29.8 million while the required on-hand inventory value, based on industry medians, was approximately \$13.8 million. The difference, \$16 million, was inventory carried by the PIA in excess of what was required when measured against median levels maintained by industry. **Table III-3**, on the next page, is a summary of the value of excess inventory by industry.

Table III-3
PIA Costs of Excess Inventory On-Hand

Industry	Average Inventory On-Hand (FY 1994/95 \$000s)	Percent of Inventory in Excess	Excess Inventory On-Hand (\$000s)	Carrying Cost of Excess Inventory (At 17%) (\$000s)
Fabric Products	\$9,344	39%	\$3,644	620
Metal Products	4,654	65	3,025	514
Wood Products	5,691	77	4,382	745
Dairy	947	31	294	50
License Plates	2,635	72	1,897	323
Meat Processing	598	43	257	44
Optical	1,037	(55)	(570)	(97)
Shoes	2,374	47	1,116	190
Printing	534	59	315	53
Concrete Precast	170	(38)	(65)	(11)
Egg Products	68	N/A	N/A	N/A
Bindery	1,781	94	1,674	284
Total	\$29,833	54%	\$15,969	\$2,715

Two notable exceptions to this inventory problem are the optical and precast concrete industries. Both industries had very lean inventory levels, beating even those private industry. The PIA has managed the inventory of these two industries extremely well.

The PIA factories and warehouses store three different types of inventory: raw materials, work-in-process, and finished goods. The volume of goods on June 30, 1995, as a percentage of total dollars in inventory was: 55 percent raw materials; 21 percent work-in-process; and 24 percent finished goods.

Costs associated with carrying inventory can be expressed as a percentage of the total inventory investment. Although these costs can vary greatly from one industry to another, the annual costs of carrying inventory generally range from 15 to 25 percent or more per year depending on the industry involved. The four components of inventory carrying costs are *obsolescence, interest, depreciation, and storage*:

-
- ❑ *Obsolescence* -- Inventory can become obsolete for a number of reasons, such as changes in models or introduction of new products. Although the need for inventory items cannot be estimated with perfect accuracy, a well managed manufacturing firm will identify surplus inventory and dispose of it. A general rule is never to hold inventories for which there is no immediate need. The cost of obsolescence naturally varies, but few companies can hold it to less than one percent of inventory value. Extreme conditions occur in the garment industry which can experience obsolescence on the order of 10 percent of the value of the inventory per year. For purposes of our analysis, we assume cost of obsolescence to be three percent.
 - ❑ *Interest* -- Capital is never so readily available that it can be invested in inventory at no cost. The cost of interest as applied to inventory is the gain that would have been earned if the same amount of money had been invested in a different manner. If money was not invested in inventory, it could always earn a rate of return at least equal to the interest of the State of California Treasurer's Surplus Money Investment Fund (e.g., 5.87 percent on June 30, 1995). For this analysis, interest costs are assumed to be six percent.
 - ❑ *Depreciation* -- Depreciation is a reduction in the value of a capital asset. In the case of inventories, depreciation relates to damage or deterioration due to storage, handling, weather, age, or pilferage. Depreciation can vary with the type of inventory, inventory policies, and facilities for storage and handling. In a prison environment, it can be assumed that depreciation is at least equal to that experienced in private industry. We have used three percent of inventory value for depreciation costs in this analysis.
 - ❑ *Storage* -- Storage is the most direct inventory carrying cost. It includes costs of storage and warehouse space (i.e., construction, utilities, and maintenance), salaries of warehouse personnel, administrative and other overhead costs, and insurance. Storage costs can vary widely with the type of material stored and type of storage facilities used. Industry storage costs are typically five percent of the value of material stored per year. We have assumed storage costs are five percent of inventory value for this analysis.

For this report, carrying costs are assumed to be 17 percent of the average annual inventory value. As Table III-3 shows, annual costs incurred from maintaining high inventories are approximately \$2.7 million, or \$7,400 per day. Fabric, metal, and wood products account for approximately 69 percent of these costs. The cost of carrying this excess inventory will continue until inventories are reduced to reasonable levels.

Table III-4, below, shows those institutions which are most effective in managing inventory levels, and those institutions which are least effective, within each industry. For example, the Pelican Bay optical factory is the most effective manufacturing operation at controlling inventory levels, while the Central California Woman's Facility clothing factory is the least effective, based on industry median inventory levels for each of these two industries.

Table III-4
Range of Number of Days in Inventory

Industry	Fewest Days in Inventory		Most Days in Inventory	
		Institution		Institution
Fabric Products	109	CMC	1,200	CCWF
Metal Products	124	Folsom	171	CSP Solano
Wood Products	157	CCI	257	Avenal
Dairy	16	CTF	36	Corcoran
License Plates ^(a)	150	Folsom	150	Folsom
Meat Processing ^(b)	29	Mule Creek	29	Mule Creek
Optical	51	Pelican Bay	71	Calipatria
Shoes	164	Pelican Bay	180	CMC
Printing	26	Folsom	189	CMC
Concrete Precast ^(c)	29	Solano	29	Solano
Egg Products ^(d)	8	Avenal	8	Avenal
Bindery ^(e)	300	Solano	300	Solano

(a) Folsom is the only factory producing license plates.

(b) Mule Creek is the only factory performing meat processing.

(c) Solano is the only factory producing concrete precast.

(d) Avenal was the only factory producing egg products.

(e) Solano is the only bindery factory.

Table III-4 also shows that some PIA industry administrators are doing a better job of inventory management than others. By identifying those institutions that operate with a lower level of inventory, and employing their best practices of inventory management at other factories, the PIA could reduce inventory carrying costs significantly.

The high inventory levels and resulting carrying costs result from a number of factors, including:

- ☐ The excessive time it takes to get raw materials ordered and delivered through the State's procurement process. In response

to these delays, PIA factories maintain very high levels of raw materials inventory to ensure they do not run out of their supply. Raw materials account for 55 percent of the inventory on-hand at June 30, 1995.

- ❑ The PIA's efforts to keep factories running without interruption. Prior to fiscal year 1995/96, the PIA made only products that were ordered by customers (in industry parlance, "made to order"). However, if PIA's production was truly in response to actual customer orders, then there would be little finished goods inventory. Because the customer is waiting for delivery, the PIA should be shipping the goods as they are produced, not storing them. Rather, it appears that products were made in advance of orders, in order to keep factories operating and inmates employed. These efforts may be why finished goods accounted for one-fourth of the inventory on-hand at June 30, 1995.

The PIA has a different explanation of why inventory levels are so high for two products: binders and license plates. During fiscal year 1994/95, the PIA maintained 300 days of bindery inventory. During the same year, the Department of General Services (DGS) purchased approximately 40 percent of binders sold by the PIA. These binders are purchased through Interagency Agreements between the DGS and the PIA. In four of these agreements, which account for approximately 89 percent of the DGS sales, the DGS required the PIA to deliver binders within 10 to 12 weeks after the PIA receives a purchase order. The agreements prevent the DGS from ordering more than 50 percent of the contract dollar value within any 30-day period.

According to PIA management, they maintain high levels of binders in order to fulfill these DGS delivery commitments. PIA management also asserts that the bindery factory would not have had the capacity to manufacture all binders if the DGS should order 50 percent of the contract dollar value within a 30-day period and still deliver the order within 10 to 12 weeks. According to the PIA, the bindery factory also loses many production days due to institution lockdowns and fog days,² and as a result, must maintain high levels of finished goods inventory for these periods when production is stopped.

We believe management's explanation for carrying 300 days of book bindery inventory is inappropriate because:

- ❑ For the years ended June 30, 1995 and 1994, approximately 56 and 66 percent of bindery inventory was raw materials, respectively. The bindery excess inventory problem is predominantly caused by high levels of raw materials, not finished goods being held so that delivery commitments to the DGS can be met.

² The CDC will not allow inmates to work at PIA factories if the fog restricts the view of CDC guards.

-
- ❑ Over one-half the bindery factory's capacity was unused during all of fiscal year 1994/95. Therefore, the factory had significant unused capacity available with which to fill large DGS orders and still meet 10 to 12 week delivery times.
 - ❑ Other factories also are subject to lockdowns and fog days but manage to operate with lower inventory levels.

The PIA also maintains 150 days of license plates. The PIA told us that the Department of Motor Vehicles requires the PIA to maintain a large quantity of license plates in finished goods inventory. However, the PIA was unable to provide us with a contractual agreement stipulating this requirement. Additionally, raw materials used to make license plates (primarily aluminum sheeting and reflective coating) comprised approximately 68 percent of the license plate inventory as of June 30, 1995. Similar to book bindery, the excess license plate inventory is predominantly raw materials, not finished goods stored in a warehouse to meet demand.

Additionally, the DGS maintains state-wide contracts for the aluminum sheeting and reflective coating used by the PIA to make license plates. The PIA should schedule delivery of these materials to meet production requirements rather than purchasing them in advance and storing excessive amounts in its warehouse.

Although inventory levels are excessive now, the PIA's new prompt delivery program may drive inventory levels higher. This new program is a "make-to-stock" process. Certain products, primarily furniture, are being produced to "build up" inventories at the prompt delivery warehouse. In fact, the Sacramento warehouse used for this new program already stores over an eight-month supply of the products now included in Phase I of the program, or twice the days of inventory on-hand as discussed previously.

Management needs to be aware of the risks and costs involved in a "make-to-stock" strategy. Should the PIA produce more products than it can sell and which then become absolute, significant losses can occur. To our knowledge, the PIA has not determined how a "make-to-stock" strategy will impact inventory levels, nor what improvements must be made in forecasting sales, planning production, and managing risks of making products in advance of orders.

Excessive inventories have been a consistent problem for several years. In a report prepared by the California Department of Corrections, Ernst & Young noted that the PIA maintained 192 days of inventory in its six largest industries.³ Since 1990, the PIA took efforts that reduced this by one-third, including implementing MAPS and improving its production planning process. However, inventory levels continue to be excessive, and the PIA has not yet effectively resolved the problem.

³ Ernst & Young, *Evaluation of Warehousing and Inventory Systems*, California Department of Corrections, July 16, 1990.

**Purchasing
Certain Raw
Materials and
Equipment
Through the
Department of
General Services
Takes Three to
Nine Months**

In order for the PIA to purchase raw materials and equipment that exceed their delegated authority of \$15,000, the PIA is required by California statute to submit a purchase estimate (for those items not covered under statewide contracts) to the Department of General Services (DGS). The DGS then selects the supplier, creates the purchase order, and places the order with the supplier. Based on interviews with PIA management, we estimate that it takes from three to nine months to receive raw materials and equipment through this State-mandated process. This process significantly disrupts PIA production plans. In response, the PIA maintains inventories of raw materials which are significantly higher than industry, incurring over \$1 million annually to carry this excess raw material inventory.

Based on interviews with PIA management, we estimate that it takes the PIA up to 30 days to process and electronically submit purchase estimates to the DGS. After the DGS receives the purchase estimate, it generally takes the DGS a minimum of 60 days to generate a purchase order for the request; this process includes a lengthy bidding process that can exceed 90 days. After the purchase order is received by the supplier, it may take as long as 60 days for the supplier to deliver the items ordered to the PIA.

The delays in obtaining raw materials forces the PIA to maintain an excessive amount of raw material inventory so that these delays do not disrupt production. As of June 30, 1995, raw materials made up approximately 55 percent of the PIA's total inventory. As presented in this report, we conclude that the annual cost to the PIA and its customers of carrying all excess inventory, including raw materials, is approximately \$2.7 million.

Another consequence of procurement delays is disruptions in production schedules that ultimately lead to delays in fulfilling customers' orders. As mentioned in this report, customers are most dissatisfied with the PIA's product delivery times.

One means of resolving these long delays is to develop a statewide contract for the raw material. Once established, these contracts allow the PIA to eliminate the time-consuming purchase order process at DGS. With these contracts, the PIA can purchase material directly off the contract at any time. The PIA now has statewide contracts for at least 78 raw materials used by its factories.

The use of these statewide contracts allows PIA factories to specify deliveries of raw materials as frequently as once per month. However, this effective use of statewide contracts varies at each institution.

In the PIA's manufacturing environment, there can be tremendous benefits if procurement delays are avoided. With better control, the PIA can work with suppliers capable of providing raw materials closer to a just-in-time basis, reducing the PIA's practice of stock piling excessive raw materials. Additionally, the PIA must be able to purchase equipment in a timely fashion to reduce lost production days resulting from equipment failure. Having control

over procurement activities provides management with the opportunity and responsibility to manage production schedules and delivery times effectively.

**The Average PIA
Product Delivery
Time Is
Unacceptable**

Based on our review of a random sample of sales orders, it took the PIA 150 days to deliver products to customers. This is the time between the customer providing the PIA with a purchase order and the date the customer receives the product. Nearly one-fifth of this time was spent by the PIA to create the paperwork needed by the factory to begin production. From the date the PIA received a purchase order, it took approximately 32 days to create a sales order for the factory.

These extremely long delays continue to be the number one complaint of customers who are extremely frustrated because they have no other option than to buy from the PIA. These delays not only cost staff time but also cost the PIA money because it slows down the time it takes to turn a purchase order into cash needed to fund the operation. By slipping just one month in deliveries, the PIA is losing approximately \$600,000 of interest earnings each year because billings and payments for customer orders are delayed.

These long delays have been a persistent problem at the PIA, and the delays have gotten worse over the last six years. A management study commissioned by the PIA in May 1990 stated that "many, if not all, product delivery times are very long, often exceeding 60 to 90 days."⁴ This 1990 PIA report noted that these long delays appear to be one of the primary reasons that state agencies are attempting to opt out of the mandatory PIA purchase requirement.

The PIA does not measure either how long it takes to deliver products nor what percentage of their products are delivered on-time. Therefore, the PIA does not know how long it takes to deliver products to customers. This delivery time information, along with the time it takes to invoice after shipment and receive payment, would measure how long it takes to turn a purchase order into cash. Without this information, the PIA does not know the key performance measure of one of its core business processes, order fulfillment. Instead of taking a strategic view of this core process, the PIA addressed delivery problems by implementing a narrow operational solution, which was building up inventory in a warehouse for its "prompt delivery" program.

We selected a random sample of 25 sales orders to determine the average days to enter a sales order, average delivery days, and average days to invoice. The sample was chosen from all fiscal year 1994/95 sales orders. If a sales order included more than one product, we chose as our sample item the highest value (dollar per unit) item from that sales order. Per instructions from the PIA, we measured delivery times from the date the customer's order is physically received at central office, which was after the date on the customer's purchase order.

⁴ MGT Consultants, *Prison Industry Authority Management Study*, May 1, 1990, page 27.

Delivery problems are caused in part by the time it takes the PIA to convert a customer's purchase order into a sales order given to the factory. The PIA steps through a process which has at least 12 discrete steps before it tells the factory to make the product. Based on the sample we selected, it took an average of 32 days for a customer's order to reach the factory. Nearly one-fifth of the average delivery time was consumed by the PIA in handling the paperwork before the factories began production.

It also takes approximately three months for factories to produce a product. This fact indicates serious problems with the PIA's ability to:

- ☐ Anticipate customers orders
- ☐ Plan and schedule production at each factory
- ☐ Standardize its production processes
- ☐ Procure raw materials through the State's inefficient procurement process
- ☐ Monitor the status of customer orders and production
- ☐ Resolve problems that occur
- ☐ Schedule and manage availability of inmates to work
- ☐ Manage inventory.

Delivery times are extremely inconsistent at the PIA. Delivery times in our random sample ranged from 4 days (eggs) to 348 days (shelving). Delivery times for the other 23 products randomly selected were somewhere in between. Because delivery times were inconsistent and ranged by so many days, the statistical confidence of this or any random sample is impacted. It would be much easier to control delivery times if the PIA measured either delivery times or the percent of orders delivered on-time.

The most serious consequence of these delays is poor customer relations. In the customer survey completed for this performance audit, only one of the 75 customers responding gave the PIA the highest possible rating in overall satisfaction. An average company will typically receive the highest satisfaction rating from 40 percent of its customers. A primary reason for this poor rating was customers' dissatisfaction with delivery delays. PIA customers expressed dissatisfaction to extreme dissatisfaction with the PIA's:

- ☐ Delivery commitments
- ☐ On-time deliveries
- ☐ Ability to keep frequently ordered items in stock
- ☐ Expediting of orders.

**The PIA Prompt
Delivery Program
Is a Costly
Solution To
Reduce Delivery
Times**

At January 24, 1996, there was approximately \$3.5 million of Phase I inventory stored in the warehouse. Compared with the PIA's forecast of fiscal year 1995/96 sales of these products in Phase I of the prompt delivery program, the PIA is carrying 252 days of inventory in the warehouse. This compares to the furniture industry median of 46 days.⁵ As a result, the PIA is incurring an annual cost of approximately \$488,000 to carry this excess inventory. In addition, the PIA could have reduced its warehouse rental costs by \$200,000 annually, if it had properly evaluated and configured the prompt delivery warehouse. Total annual excess costs of this new program are \$688,000.

Using PIA's fiscal year 1995/96 sales forecasts, we used the following data and assumptions to calculate how many days of inventory are now stored in the Sacramento warehouse:

- ☐ Phase I product sales = \$7.0 million
- ☐ Gross margin for wood products = 28 percent
- ☐ Cost of goods sold (COGS) = (\$7.0 million x (1 - 0.28)) = \$5.0 million
- ☐ Inventory turns per year = (COGS/Inventory) = (\$5.0 million/\$3.5 million) = 1.43
- ☐ Days in inventory = (360/1.43) = 252 days.

When compared with an industry median of 46 days, the PIA is storing approximately 206 excess days of inventory. This is 82 percent (206/252) of inventory in excess of the industry median. Assuming a carrying cost of 17 percent of the value of inventory, the PIA is incurring costs of approximately \$487,900 annually to carry this excess inventory. We made this estimate as follows:

Phase I "prompt delivery" inventory	\$3,500,000
Times: 82 percent of inventory in excess	\$2,870,000
<u>Times: Carrying cost</u>	<u>17%</u>
Equals: Excess carrying cost	\$487,900

The PIA currently leases a 114,000 square foot warehouse to store prompt delivery products. The base rent is \$0.29 per square foot each month, or \$399,561 annually. During our visit to this warehouse, we found that the PIA is not utilizing warehouse space efficiently. Also, we observed that approximately half of the warehouse floor space was unused. There are no storage racks used in the warehouse, nor does the PIA have plans to purchase such racks. Without storage racks, it is difficult to stack inventory and optimize clear height levels. Also, several of the aisles between storage areas

⁵ As reported by Robert Morris Associates, *Annual Statement Studies 1995*, which provides comparative financial data for thousands of companies operating in over 100 industries.

are wider than the necessary eight feet, reducing floor space available to store goods. As a result, the PIA is not maximizing total warehouse cubic space. In fact, it may only now be using 10 to 15 percent of the available space in the Sacramento warehouse. If the PIA could reduce inventory levels to reasonable levels, install storage racks using narrow aisles, and use appropriate material handling equipment, the PIA could easily service the prompt delivery program with less than half the space it now rents. This would reduce annual rental costs by at least \$200,000.

The PIA is planning to add more products to the warehouse during Phase II and III of the program. However, even if more floor space is used by adding products, we estimate that the PIA will be unable to use more than 20 percent of the total warehouse cubic space because there are no storage racks and because the space reserved for aisles is more than necessary. Industry averages for warehouse space utilization are in the range of 30 to 40 percent.

During our visits to five of California Department of Corrections (CDC) institutions, we observed that less than 20 percent of the total warehouse cubic space available for use by the PIA was utilized. As a result, the PIA may have available twice the storage capacity at CDC institutions than it currently uses. Given that there is available warehouse space at these other PIA facilities and the inefficient use of the Sacramento warehouse, we question the appropriateness of the size of, and even need for, the Sacramento warehouse.

The PIA did not conduct a formal evaluation to determine either the size or configuration of the warehouse needed for the prompt delivery program. Also, the PIA did not determine the amount of warehouse space it already had available at its own facilities. The failure to perform even a rudimentary evaluation of existing warehouse space or projected needs to effectively distribute the prompt delivery products is surprising.

The prompt delivery program represents a significant departure from how the PIA fulfills customer orders. Historically, the PIA would receive a customer order and then forward the order to one of its factories to be manufactured. This process is termed "make-to-order"; the product is not made until a customer orders it. In such a make-to-order process, each customer's order is prioritized against other orders and then scheduled for production. Actual production may not begin for days, weeks, or even months after the order is received. This process is a primary reason why the PIA's delivery times are unacceptably long.

Under the new prompt delivery program, the PIA manufactures the selected furniture items, then ships the furniture to the Sacramento warehouse. The PIA then fulfills customers orders for selected furniture products from inventory "stocked" in the Sacramento warehouse. This process is termed "make-to-stock."

Because this furniture is stocked in the warehouse, the PIA is able to meet its delivery commitments of 8 days or less in Sacramento, and 20 days or less statewide. Initial customer response to the program has been very positive. However, we believe the make-to-stock concept is a very expensive and an unnecessary solution to reduce delivery times. With effective forecasting and production planning techniques, we believe the PIA can reduce delivery times without substantially increasing either product inventory levels or warehouse costs.

In fact, state law requires the largest state agencies to assist the PIA in forecasting customer orders. Penal Code Section 2807(c) requires 12 state agencies to provide the PIA with planned future use of PIA goods and services. The PIA has not asked for, and has never received, these plans from state agencies. The PIA has missed an extremely valuable source of information to forecast customer orders effectively. Effective forecasting and production planning for products is not only common in a manufacturing environment but considered essential for an entity's existence in a competitive market.

**The PIA Has
Unused or
Underutilized
Warehouse Space**

Although the PIA carries significantly more inventory than is commonly needed by a manufacturing operation, it still uses very little of the warehouse space it is provided at each prison. Based on visits we made to six PIA factories, as little as 15 percent of the warehouse space is used to store inventory; the remaining space is empty. Industry standards are 30 to 40 percent utilization of warehouse space.

The primary reason the PIA has such large unused space is that the CDC built the warehouses too big rather than building smaller warehouses that are configured to be used more efficiently. The CDC chose the more expensive option of building larger warehouses with more floor space and more storage racks rather than efficiently using storage racks and narrow aisle operating equipment so that smaller warehouses would suffice. As a result, the CDC may have unnecessarily spent \$485,000 more for each PIA warehouse than is needed if the space were used more efficiently.

Excess warehouse space has been a chronic problem for the CDC in its design and configuration of PIA warehouse space. A July 1990 study performed by the CDC found that its warehouse standard design was less efficient and less effective than found in industry. As first noted in this 1990 study, the PIA also continues to operate warehouses with wide aisles, without adequate storage racks (which would allow efficient use of the cubic space in the warehouse), inefficient placement of storage racks where racks are installed, and inefficient use of the ceiling height.

The PIA recognizes that it is less expensive to "go up" rather than "go out" in building and configuring a warehouse. That is, it is much less expensive to build a warehouse with a smaller footprint, place storage racks closer together, and use narrow aisle equipment, than it is to build a warehouse with more square feet with storage racks placed farther apart. The CDC built PIA

warehouses with larger footprints than necessary, rather than design smaller warehouses which are configured to use the warehouse envelope more efficiently.

We were unable to obtain the total square feet of warehouse space built by the CDC and occupied by the PIA. A typical 50,000 square foot warehouse used by the PIA may cost at least \$1,000,000 to build, excluding financing costs and improvements. Because the PIA only needs half this space, the CDC would have spent \$500,000 more on the warehouse than what the PIA actually needs. The CDC still would have purchased storage racks regardless of the size of the warehouse, and may have needed fewer racks in a smaller warehouse (although using narrower aisles in a smaller warehouse could require the same number of storage racks as a larger, inefficiently used warehouse).

One additional cost of designing and configuring a more efficient warehouse would be the difference in price between typical material handling equipment (e.g., forklift) and narrow-aisle equipment (e.g., a forklift which can operate within an eight-foot wide aisle). Assuming three pieces of equipment are needed, and a price premium of \$5,000 per narrow-aisle equipment, then the net cost to purchase the narrow aisle equipment could be \$15,000. Therefore, the net cost to the General Fund of the CDC's overbuilding one typical warehouse is \$485,000. The PIA operates manufacturing factories at 19 CDC prisons. We do not know how many warehouses are used by the PIA.

**The PIA Does Not
Adequately
Coordinate
Production
Planning With Its
Customers**

Penal Code Section 2807(c) requires twelve state agencies to report annually to the Director of General Services and to the Chairperson of the Joint Legislative Budget Committee regarding their prior fiscal year and planned future use of products and services provided by the PIA. These reports are not prepared. These 12 customers account for over 90 percent of PIA sales. The PIA is not responsible for enforcing this statute nor requiring that the 12 agencies submit these reports. However, if the PIA were to work effectively with these 12 agencies and coordinate their planned purchases of products and services, it could begin preparing forecasts of unit demand rather than just aggregate revenues, and it could know one year in advance what more than 90 percent of its annual demand may be.

For example, the California Department of Corrections (CDC) places large orders for regularly consumed items on an irregular basis. The CDC also accounts for approximately 57 percent of the PIA's annual sales. However, despite having a fairly predictable inmate population for the next 12 months, and having a constant need for PIA products, CDC institutions do not place regularly scheduled orders. This issue was raised in a study conducted by the CDC over five years ago.⁶ In this study, the CDC recommended that it place an annual order for PIA produced clothing, and requested that this clothing be shipped monthly. The CDC still has not implemented this recommendation.

⁶ Ernst & Young, *Evaluation of Warehousing and Inventory Systems*, California Department of Corrections, July 16, 1990.

The PIA, which participated in the same study, also has failed to implement this improvement with the CDC and its other major customers.

Because the 12 state agencies do not prepare the future use reports, and because the PIA does not effectively coordinate production planning with these customers, the PIA finds it difficult to forecast sales and plan production. As a result, the PIA must constantly adjust production schedules to accommodate uneven and unexpected orders and frequently disrupt scheduled production because a CDC institution submits an unexpected order. Moreover, the PIA tends to maintain a significantly larger inventory than would be necessary if production were better planned and scheduled.

**The PIA Does Not
Prepare Forecasts
of Unit Sales and
Production**

At present, the financial section of the PIA's most recent five-year business plan contains some limited forecasts of projected sales, cost of sales, and profit (or loss) by industry category. This plan does not include forecasts of unit sales which tie to the PIA's revenue forecasts. The lack of unit sales forecasting capabilities severely limits the PIA's ability to plan production and assign orders. As we understand it, the PIA's central office prepares these financial projections with little input from industry managers, factory superintendents, and facility administrators who understand the industries.

This inability to develop forecasts of unit sales is a key weakness recognized by PIA management. Without knowing what unit sales will be, it is difficult for the PIA to develop short-term and long term forecasts of manufacturing requirements, such as delivery requirements, finished goods requirements to fill orders by month and week, raw materials requirements based on delivery and finished goods requirements, and loading of each of the PIA's 73 factories (how much each factory will produce of what product each week). Without unit forecasts, the PIA cannot develop schedules which will utilize the machine-time and inmate resources to their maximum capacity. Also, it is nearly impossible to develop pricing strategies for each product without knowing what unit sales may be. As PIA management told us, without unit forecasts, it is impossible to reflect the "best value" in the production plan to maximize the PIA's returns on investments in plant and equipment. Without knowing how many units will be produced it is difficult to optimize factory utilization.

**The PIA Has Too
Many Products**

The PIA has expanded its operations into 31 diverse industries at 73 factories across the state. The result is a diffusion of management responsibility and accountability, a shortage of managers who are experienced in running these industries, inconsistent and wide swings in the financial performance of each factory, and an inability to develop plans for expanding, reducing, or discontinuing products. Maintaining a large product line also results in frequent change-over in production runs, additional waste, and raw materials ordered in less than economic quantities. As a result, state agencies subsidize inefficiently run operations, pay prices which exceed the PIA's cost of making the product, and experience delays in getting products delivered.

The PIA operates 31 core industries with 1,748 core products and approximately 28,000 discrete products. A discrete product is generally a style variation of a core product. For example, the Ultra II ergonomic chair is a core product that is marketed in various colors and options. The various colors and options become discrete products within the core product.

The PIA's expansion of industries and products appears to have resulted from its attempt to provide employment for a rapidly increasing prison population. As the population expanded, the PIA expanded into new industries and offered a myriad of different products to state agencies.

The PIA recognizes that it has too many core and discrete products. One of PIA's four strategies is to narrow the focus of products. The focus of this strategy is to eliminate certain unprofitable core products, limit the number of discrete products available to customers, and examine the impact on inmate employment. For example, the PIA promises delivery for 38 furniture products that are stocked in a Sacramento warehouse within 20 days. However, only certain discrete products are available. For example, if the customer wants ten Ultra II ergonomic chairs within 20 days, the customer must select from colors already stocked. If a customer wants a color not stocked in the warehouse, the customer's order becomes a "make-to-order" and the customer may have to wait months before the chairs are manufactured and delivered.

Generally, a manufacturer will operate in only those industries it knows well. For example, a furniture maker would not likely branch into a dairy because the dairy is not a core competency, and the furniture maker would not have special expertise to run the dairy efficiently and effectively. In addition, a manufacturer would not enter into a business which it cannot at least breakeven within a reasonable time period.

The PIA does not have the expertise to operate 31 industries or to manufacture 1,748 products efficiently and effectively. Although the PIA does employ factory level supervisors with specific, and often, in-depth knowledge of a single industry or product, we determined through interviews that factory administrators and central office management generally do not have in-depth knowledge of all the products they manage. Management's industry and product expertise quickly becomes diluted the further away a manager is from the factory floor.

The PIA has not designated a single individual to be responsible for the costs and performance of a single industry. Rather, "everyone" at PIA is responsible for a specific industry's costs or ability to break even, according to PIA management we interviewed. As a result, no one is responsible for the cost-effectiveness of an industry.

The PIA's fairly rigid organizational structure, which is common in the State, diffuses the responsibility and accountability for all industries and products. Though the factory managers we interviewed feel responsible for that factory's costs, most of the activities critical to achieving a self-supporting factory are

performed by the central office in Folsom. These centrally performed activities include sales and marketing, production planning, production assignments to factories, procurement review and approval of purchase estimates, customer service, and fiscal management.

There are three branch managers at PIA's central office that oversee the 31 industries and 1,748 products.⁷ We believe that it is not possible for four branch managers to have the necessary in-depth industry knowledge to effectively manage and oversee operations of 31 diverse industries. For example, one branch manager oversees the diverse needs of laundry, optical, printing, bindery, general fabrication, cleaning products, paper products, key data entry, micrographics, dental lab, silk screening, and fiberglass industries.

Because management expertise is diluted, the PIA essentially manages its business at the factory level rather than at the product level. As we discuss earlier in this Chapter, the PIA does not have accurate product cost information. Therefore, it is nearly impossible to manage operations, identify or manage product profitability, identify products that are losing money, or develop plans to acquire, grow, reduce, or discontinue product lines. In addition, we found through the course of our interviews that no one person accepts full responsibility for profitability of either products or industries.

This dilution of management responsibility results in products and industries which lose money. The negative financial effects of these losses are hidden in the PIA's financial results because some factories which sell products priced above full costs subsidize those factories and products that are not self-supporting. State agencies which purchase these profitable products are subsidizing the cost of those factories and products that lose money.

Customers Are Not Satisfied With PIA Performance

Based on a survey we conducted for this performance audit, customers are not satisfied with the PIA, and they are particularly upset with long delivery times and higher prices. Of those who responded to our detailed questionnaire, 71 percent felt that the PIA was worse than other suppliers.

In the survey, we asked customers to rate their overall satisfaction with the PIA. Only one respondent gave the PIA a five, the highest rating. These results are especially disturbing when compared to results of hundreds of such customer surveys conducted nationwide. In these surveys, the average company will receive the highest satisfaction rating from at least 40 percent of their customers. In an interview with The Gallup Organization, a nationally respected consumer survey firm, we found that 80 percent of an average company's customers will give the company the top two ratings of the scale (i.e., a four or five). However, just 30 percent of PIA's customers gave the highest two ratings. Based on these results, it would be difficult for the PIA to retain its customer base in a competitive and open market.

⁷ A fourth manager is responsible for one industry, the material recovery (recycling) facility.

Studies have shown that customers expect to be satisfied (a four on our scale of 1 to 5). When customers give a five rating, they are indicating value that exceeds expectations. Research shows that extremely satisfied customers are loyal and are more likely to repurchase products and services. Ratings less than a four indicate dissatisfaction. In a competitive and open market, customers who indicate dissatisfaction will generally be lured away by competitors.

We determined those PIA characteristics with which customers were most satisfied by determining which survey questions received the highest number of 4s and 5s on the rating scale. Generally, customer service was rated very high by PIA customers, as shown in the top half of **Exhibit III-1**, on the following page.

Customers were most dissatisfied with long delays in getting products delivered, as well as with the prices charged by the PIA. The bottom half of Exhibit II-2 shows the five characteristics receiving the greatest number of the lowest two ratings (1s and 2s on the survey scale).

We also wanted to know what characteristics are most important to customers. Respondents indicate that timely delivery is the most important characteristic to them, followed by reasonably priced products and services. Unfortunately, customers were most dissatisfied with PIA's performance with respect to both these characteristics.

Delivery

As the PIA has known for at least five years, customers are clearly dissatisfied with how long it takes the PIA to deliver its products. For example, 54 percent of respondents indicated their dissatisfaction in response to questions pertaining to delivery. When asked if the PIA provides reasonable delivery commitments, 58 percent of respondents were dissatisfied or extremely dissatisfied. Additionally, 56 percent were dissatisfied or extremely dissatisfied with delivery times.

Timely delivery of products and services is considered extremely important to 73 percent of the respondents. Additionally, 55 percent of respondents indicate that PIA delivery times have remained the same over the last three years, while 40 percent indicated delivery times have improved. Although there is indication that delivery times are improving, it is apparent that much improvement is still needed. Below are selected comments from customers with respect to delivery:

- ☐ "Delivery time of items is unacceptable"
- ☐ "Items such as clothing, regardless of type or article, are not stocked which causes a six to nine month delay between order date and receipt of items"

Results of PIA Customer Satisfaction Survey

Questions receiving most 4s and 5s: (Satisfied to Extremely Satisfied)

Percent of Those Responding

Customers are most satisfied with how the PIA:

Processes waivers in a timely manner

67%

Makes it easy to place an order

66%

Provides clear invoices

64%

Treats them as an important customer

59%

Resolves problems that occur

56%

0% 25% 50% 75%

Questions receiving most 1s and 2s: (Extremely Dissatisfied to Dissatisfied)

*Customers are most dissatisfied with
how the PIA:*

Provides reasonable delivery commitments

58%

Delivers on time

56%

Keeps frequently ordered items in stock

54%

Makes it easy to expedite orders

46%

Delivers reasonably priced products

43%

0% 25% 50% 75%

-
- ☐ "Three to nine month waiting periods to fill an order is not reasonable business practices"
 - ☐ "Dental prosthetics, optical, and food services are timely. Delivery dates are not met for virtually any other item ordered"
 - ☐ "Makes delivery commitments that are never achieved"
 - ☐ "Delivery commitments are unpredictable"
 - ☐ "Cannot depend on PIA to expedite orders"
 - ☐ "Except for the Prompt Delivery Program, in most cases items are not delivered when promised"
 - ☐ "Prompt Delivery Program has improved delivery times"
 - ☐ "I know they put into place the 20-day delivery program. It would be nice if more items were available this quickly."

Price

Customers were generally dissatisfied with PIA prices for products and services. When asked if PIA prices are reasonable, 43 percent of respondents indicated dissatisfaction or extreme dissatisfaction, 32 percent were satisfied or extremely satisfied. Furthermore, 69 percent of respondents indicated that the PIA remained or became a higher price alternative over the last three years.

Reasonably priced products and services is considered extremely important to 60 percent of respondents. Below are selected comments from customers with respect to PIA pricing:

- ☐ "PIA prices are not competitively priced"
- ☐ "PIA pricing is high compared to outside vendors"
- ☐ "Prices are seldom competitive with private sector pricing"
- ☐ "I can usually beat the price of furniture items on the open market"
- ☐ "Office furniture items are reasonably priced considering the quality of product."

Quality

Results with respect to the quality of products and services were more favorable than results pertaining to delivery and price. Responses to questions pertaining to quality indicate that 39 percent of respondents were satisfied with quality, 27 percent were dissatisfied. Additionally, 73 percent of respondents indicate that quality over the last three years has remained the same, while 23 percent indicate improvement.

The quality of products and services was considered extremely important to 55 percent of respondents. Below are selected comments from customers with respect to quality:

- ☐ "Wooden furniture is of exceptionally high quality"
- ☐ "Only experienced occasional problems which were corrected in a timely manner"
- ☐ "Some items are great, others are acceptable"
- ☐ "Products are inferior and in poor working order"
- ☐ "Clothing is poorly made."

Customer Service

Respondents are most satisfied with the PIA's customer service. Responses to questions pertaining to customer service indicated that 53 percent of respondents were satisfied or extremely satisfied. With respect to timely processing of waivers, 67 percent of respondents were satisfied or extremely satisfied. Additionally, 66 percent of respondents indicated that the PIA makes it easy to place an order, and 59 percent believe that the PIA treats them as an important customer. Furthermore, 49 percent of respondents indicated that customer service improved over the last three years, while 48 percent indicated it had remained the same.

Customer service is considered extremely important to half of the respondents. Below are selected comments from customers with respect to customer service:

- ☐ "Customer service has been very cooperative"
- ☐ "If problems arise, they are helpful"
- ☐ "Waivers are easy to get processed"
- ☐ "Returns are processed in a reasonable time frame"
- ☐ "Customer service is adequate when dealing with staff. However, often we have to deal with inmates who are unable to assist"
- ☐ "Management is not responsive to customer needs"
- ☐ "PIA needs to be more customer oriented. They need to develop an expediting system of notifying the customer when there is a problem rather than responding only when customers make inquiries."

When results of a customer satisfaction survey expose serious problems, reaction by management may vary. Good management will embrace the results, commend the workforce for those areas receiving the highest satisfaction, and work to correct those areas where customers are seriously concerned with the company's performance and responsiveness. We hope that PIA management will embrace the results of this survey and use the results to improve performance.

**The PIA
Should Improve
Its Cash
Management**

Although the PIA monitors its daily cash balance and summarizes historical cash flow information on a monthly basis, the PIA does not prepare monthly cash flow projections. The PIA's fiscal year 1995/96 annual plan displays the annual revenue and expense budget but does not project monthly cash balances for the fiscal year. Historically, the PIA has not prepared monthly cash flow projections. As a result, the PIA missed an opportunity to pay-off its long-term debt obligations earlier than scheduled and incurred approximately \$755,000 in additional interest expense as a result. Clearly, the PIA could improve its cash management.

An organization that effectively manages cash would generally monitor current cash balances and requirements, as well as project future cash balances and requirements. Additionally, an organization generally tries to maximize return on its cash reserves. The PIA recognizes that businesses typically maintain one month of operating requirements in cash.

At June 30, 1993, the PIA had long-term debt of approximately \$15.1 million, and approximately \$31.2 million of cash. This cash included amounts due from the General Fund which the PIA can request fairly easily to pay expenditures. From June 30, 1993 through June 30, 1995, the PIA's monthly cash balance, including the State General Fund borrowings, averaged \$32 million; at no time did the monthly ending cash balance fall below \$26 million during this period.

At June 30, 1993, the PIA had enough cash to pay-off all of its debt and still had enough to cover more than one month's operating expenses without using any receipts. Even though the PIA made two prepayments of debt in fiscal years 1993/94 and 1994/95 of \$3 million and \$4.5 million, respectively, the PIA could have paid-off its entire debt balance by June 30, 1993.

The PIA's borrowing rate from June 30, 1993, through June 30, 1995 exceeded the Surplus Money Investment Fund (SMIF) rate the PIA earned on its cash balance. As displayed in **Table III-5**, on the next page, had the PIA paid-off its debt balance on June 30, 1993, the PIA would have saved approximately \$756,000 in interest expense. At June 30, 1995, the PIA had a cash balance of approximately \$30.2 million yet still maintained a debt balance of approximately \$5.2 million. Because the PIA's borrowing rate exceeded its return from the SMIF, it would be more effective to pay down the debt with the cash available.

Table III-5
Prison Industry Authority
Unnecessary Interest Expense
(\$000s)

	June 30, 1994	June 30, 1995	Total
Average Borrowing Rate ⁽¹⁾	8.20%	8.10%	—
Average SMIF Rate ⁽²⁾	4.45%	5.12%	—
Interest Rate Spread	3.75%	2.98%	—
Average Debt Balance ⁽³⁾	\$13,400	\$8,500	—
Unnecessary Interest Expense	\$503	\$253	\$756

(1) Source: Audited financial statements.

(2) Source: State Controllers Office.

(3) Source: Audited financial statements (beginning debt balance + ending debt balance)/2.

In December 1994, the PIA developed a cash reserve policy establishing a reserve equal to two months operating costs. PIA concedes that a two-month reserve is more conservative than reserves in the private sector, which it concluded would typically establish a reserve of one month's operating costs. According to the PIA General Manager, the PIA maintains a cash reserve higher than those in the private sector because:

- ☐ The private sector has a greater capacity to influence and target its customer base than does the PIA; it can also respond more quickly to sharp downturns and adjust as necessary.
- ☐ The potential impact of budget cuts in State operations is unknown, and these could affect the level of PIA sales.

We believe it is not necessary for the PIA to maintain a two-month operating cash reserve of approximately \$26 million (at June 30, 1995) because:

- ☐ The PIA has a captive State market substantially free of competitors, so the risk of competitors taking these customers away and reducing PIA sales away is small. Also, these customers pay their bills fully and quickly, ensuring the PIA of cash flow.
- ☐ The PIA's monthly cash receipts are about the same as its monthly disbursements. During fiscal year 1994/95, there was no single month in which disbursements exceeded receipts by more than \$4 million. For the entire fiscal year 1994/95 disbursements exceeded receipts by just \$4.2 million. Further, during both fiscal years 1992/93 and 1993/94, total cash receipts were more than cash disbursements.

-
- The PIA could establish a line of credit with a bank to cover unexpected drops in cash flow resulting from severe budget cuts or delays in the State's budget approval process. Doing so would alleviate the need to maintain high cash reserves for sudden or unexpected cash needs. Although the PIA could borrow from the General Fund, doing so requires legislation, and this could take months to obtain.

**The PIA Was
Required To
Provide an
Interest-Free Loan
to the General
Fund, Losing \$3
Million in Interest**

State law allows the California State Controller to borrow all or a portion of the PIA's cash balance invested in the SMIF without paying PIA any interest on the borrowed amount. The inability for the PIA to earn interest on amounts borrowed by the General Fund is unreasonable and unfair, especially because the PIA must be self-supporting. The loss of interest income also impedes the PIA's ability to maximize its return on capital.

The PIA is not paid interest for cash borrowed from it by the California State Controller because of a provision in Government Code Section 16310:

"When the General Fund in the Treasury is or will be exhausted, the Controller as so ordered by the Governor, may direct the transfer of all or any part of the money not needed in other funds or accounts to the General Fund from those funds or accounts including the Surplus Money Investment Fund or the Pooled Money Investment Account. All money so transferred shall be returned to the funds or accounts from which it was transferred **without interest** as soon as there is sufficient money in the General Fund to return it." (emphasis added)

When the PIA has excess cash on-hand, the State Controller will borrow these funds. When the State Controller borrows PIA funds, the PIA loses interest it otherwise would have earned had funds remained in the SMIF. This expropriation of funds cost the PIA approximately \$3 million from fiscal years 1988/89 through 1994/95. **Table III-6**, on the following page, shows how this lost income is determined. The table shows the year-end balance of PIA funds borrowed by the General Fund and a calculated average annual balance. The interest rates used to calculate the estimated lost interest income are the average SMIF rates for the respective fiscal years.

Table III-6
Prison Industry Authority
Estimated Lost Interest Income
From Non-Interest Loans to General Fund
(\$000s)

Fiscal Year End June 30	Due From General Fund (a)	Average Balance (b)	Average SMIF Rate (c)	Estimated Loss to PIA
1989	\$0			
1990	5,300	\$2,650	8.75%	\$232
1991	7,700	6,500	8.18%	532
1992	15,500	11,600	6.69%	776
1993	13,000	14,250	5.03%	717
1994	13,000	13,000	4.45%	579
1995	0	6,500	5.12%	333
Total				\$3,169

(a) Source: Audited financial statements.

(b) Average of the "Due from General Fund" balances of prior and current fiscal year.

(c) Source: State Controllers Office.

During this performance audit, we noted a number of accomplishments and milestones attained by the PIA. Though we briefly refer to many of these in the report, we present them below for the benefit of the reader to better understand the progress that the PIA has been made in a number of areas. These accomplishments highlight the dedication and hard work of staff throughout the PIA, and they demonstrate that management's commitment to continuous improvement can result in positive change.

**The PIA Has
Significantly
Improved Delivery
Times for Selected
Standard Furniture
Products Included
in Its "Prompt
Delivery" Program**

In responding to a 1994 survey which the PIA conducted, PIA's customers voiced their dissatisfaction with how long it took to get products delivered. In response to these concerns, the PIA introduced the Prompt Delivery Program in the fall of 1995 and has since significantly reduced delivery times on the furniture available through this program.

Under the new program, the PIA promises to deliver selected standard products (primarily furniture) in 20 working days or less within the State, and in 8 days or less for Sacramento customers, from the date an order is received. The selected products are stored in, and shipped from, a 114,000 square foot leased warehouse in Sacramento.

The PIA is introducing prompt delivery of products to customers in three phases. Phase I now includes approximately 38 primary furniture products with approximately 100 different styles. Fiscal year 1994/95 sales for these Phase I products were approximately \$5.6 million, or 3.7 percent of PIA's total sales. Additional products will be added during Phases II and III. The PIA has not determined which products will be offered in Phases II and III.

We selected a random sample of one month's deliveries of selected prompt delivery products and found that delivery times averaged approximately 11 days. Some deliveries included in our sample were delivered to the customer in as little as five days after the customer placed the order.

The response by customers to the short delivery times has been overwhelming. Many customers responding to the satisfaction survey conducted for this performance audit specifically noted that they were extremely satisfied with the prompt delivery program. Also, customers have mailed letters to the PIA complimenting them on the program. One letter states: "Today, you have one very satisfied customer," and another says "Your Prompt Delivery Program is a real winner." The PIA has significantly improved delivery times for these selected products.

The PIA's Optical Labs Are Successful

The State and the taxpayers benefit in several ways when the PIA provides goods or services to a state agency at or below market costs. First, if the PIA's prices are set to recover the state's true costs and they are still below market prices, the State and the taxpayers benefit from the savings. Secondly, the CDC is able to provide inmate programming at no cost to the taxpayers which, according to the CDC, reduces inmate idleness, creates a less violent environment, and provides the inmates with the opportunity to acquire a work ethic and job skills. Finally, the taxpayers and society in general may benefit when inmates do acquire a work ethic and job skills they can utilize once they are released back into society. Therefore, inmates may be less likely to commit another crime and return to prison. The PIA's optical lab industry is an example of such a "win-win" situation.¹

The PIA entered into a contract with the Department of Health Services (DHS) in 1987 that authorized the PIA to become a MediCal provider of optical lenses for MediCal patients. The PIA has optical labs in three prisons throughout the state which currently service MediCal patients in 49 counties. During fiscal year 1994/95, the PIA optical labs processed 424,458 orders.

MediCal patients in need of glasses visit an optometrist to have their eyes examined and select the frames for their glasses. The optometrist then sends the frames and the prescription to the designated PIA optical lab. The PIA optical lab grinds the lenses to the optometrist's prescription, shapes and mounts the lenses in the frames, and sends them back to the optometrist. The optometrist then confirms that the glasses meet the prescription and provides them to the patient. This process is essentially the same process that occurs for many, if not most, non-MediCal patients.

The contract between the DHS and the PIA requires that the PIA maintain performance levels consistent with that of the private sector. The primary indicators of performance are the percentage of prescriptions processed late and the percentage of prescriptions that are completed incorrectly. The standards set by the DHS are no more than five percent late orders and three percent processed incorrectly. During 1995, the PIA did not meet the performance measure for late orders, with 6.2 percent being late, while it exceeded its performance measure for incorrect prescriptions, with only 2.8 percent of the prescriptions needing to be redone.

The reimbursement rate established by the DHS is \$21 per prescription on average. These rates appear to recover the state's costs to operate the optical labs. In fact, our analysis of the PIA's financial statements indicates that the optical labs generated reimbursements of \$575,000 in excess of the costs (including an allocation of non-production costs). In addition, according to the DHS, the taxpayers save approximately \$360,000 annually (\$180,000 state General Fund and \$180,000 federal funds) because the rates charged by the

¹ All of the data provided by the PIA and the DHS is unaudited. However, the information is consistent with our observations during the course of our audit.

PIA are lower than those that would have otherwise been paid by the DHS to optometrists.

Finally, the optical labs in the PIA provide meaningful work experience for over 300 inmates. The PIA expects that number to grow to 450 when seven more counties and a fourth lab are activated June 1, 1996. The majority of these inmates have had vocational training before being assigned to PIA optical labs. This training is enhanced through on-the-job training and job rotation until those inmates who demonstrate their ability have been trained in virtually all phases of the lab. According to the PIA, numerous inmates have gone on to become successes in the optical field after their release from prison.

**The PIA Compares
Favorably With
Programs
Operated by Three
Other States and
the Federal
Government**

Based on our research, the PIA compares favorably to correctional industries in Texas, Florida, New York, and the federal government. The PIA is within mid-range for several key measures of performance: annual sales per free-staff, gross profit margin, days of inventory on hand, and days of accounts receivable. The PIA's net income reported on financial statements is the highest among the four other correctional programs. **Appendix E** to this report provides more details regarding each state's correctional industry, including size, operations, and financial results.

All correctional industries utilize buildings and equipment that were contributed to it by an external fund. However, none of the programs pay interest or bond costs related to this contributed capital. All programs, except Florida and the federal government, recognize depreciation on the contributed capital. Finally, utility costs are paid by all programs, except that of Texas.

The PIA, as well as Florida and the federal government, is not permitted to sell to either non-profit or private industry. The PIA's product offering is the most diverse, and the PIA operates approximately twice the number of industries as the other correctional industries. Correspondingly, the number of industries representing 80 percent of the PIA's sales are greater than any of the other correctional industries.

All correctional industries require government agencies to purchase the products made (mandatory sourcing). However, Florida does not exercise its mandatory sourcing, but rather competes for customers with private industry. The mandatory sourcing statutes for Florida and Texas permit a waiver if the industry's product or service does not meet comparable performance specifications and comparable price and quality requirements.

Statutes regarding inmates vary considerably among the five correctional industries. Texas statutes (Sec 497.002) require useful work experience and appropriate job skills to facilitate reentry into society. Texas statutes further require an economic benefit to the public and the department through effective utilization of inmates. New York statutes (Sec 183) require employment, so far as practicable, in occupations which inmates may most

likely obtain employment after release. Federal government statutes (Sec 4122) require employment for the greatest number of inmates as far as practicable. Of the five programs, only Florida provides a direct, external payment of a benefit – 0.3 percent of the program's gross sales are paid to a Victim Restitution Fund.

Federal statutes (Sec 4122) require the Federal Prison Industries (FPI) to conduct its operations so as to produce products on an economic basis but to avoid capturing more than a reasonable share of the market among federal departments, agencies, and institutions for any specific product. Further, the FPI is required to diversify its products so that its sales are distributed among its industries as broadly as possible.

We requested pricing and cost information for six PIA products selected for this performance audit, and we received reliable information on four products. **Table IV-1**, below, shows the products for which we obtained comparison data.² The PIA's prices for the wood furniture product and metal product are comparable to prices charged by the three other programs. The PIA's prices for the food and fabric products are higher than the one state making either product. The PIA's costs for all four products are comparable with the other correctional industries.

Table IV-1
Comparable Products Manufactured
by Other Correctional Industries

PIA Product	Comparable Product			
	Texas	Florida	New York	Federal
Wood Furniture Product	Yes	No	Yes	Yes
Metal Product	Yes	Yes	Yes	No
Food Product	No	Yes	No	No
Fabric Product	No	No	Yes	No

Among the five correctional industries, only New York manages and records costs to the discrete product. For metal product and fabric product, New York's costs are tracked to the discrete product and for the wood furniture product comparable to the PIA's wood furniture product, New York tracks costs to the product line. Unlike the PIA, New York conducts weekly meetings to examine and resolve variances in actual costs from expected costs.

² The PIA believes that its product costs are proprietary and requested that this report not disclose the names of the specific products we selected for review.

One distinctive provision of the PIA's statutes from the other four programs is that some of the State's largest agencies are required to inform the PIA of planned purchases of PIA goods and services. Penal Code Section 2807(c) requires twelve state agencies to report annually to the Director of General Services and to the Chairperson of the Joint Legislative Budget Committee regarding their prior fiscal year use and planned future use of goods and services provided by PIA. These reports are not and have not been prepared. If the PIA were to work closely with these agencies, it could begin preparing forecasts of unit sales, rather than aggregate revenues, and could know potentially one year in advance what more than 90 percent of its annual demand may be.

**The PIA Obtained
Four Patents for
Century 2000**

Century 2000 is a line of modular panel office systems custom designed for customers. Modular panel office systems consist of workstations and partitions seen in many office environments. The Century 2000 line includes approximately 2,500 initial components and 750 finished components. The PIA considers Century 2000 to be one of the finest modular panel office systems on the market.

In 1995, the PIA obtained a patent for one of its finished component parts, the "modular component attaching system" which improves the cost and serviceability of this furniture. In addition, the PIA obtained a patent for the design of a panel which the PIA claims meets higher acoustical standards than the panels of other suppliers. Two other patents were obtained, one for a wall panel leveling device and one for a hinge and rail connection device. A patent is an exclusive right to make, use, or sell a particular invention that is granted by the federal government to the inventor for a period of 17 years. The patents are tremendous accomplishments and demonstrate the creativity of PIA personnel and their capacity to add value to the manufacturing process.

**The PIA
Adequately
Manages Accounts
Receivable**

The PIA effectively managed its accounts receivable during fiscal year 1994/95. During that year, it took the PIA an average of 44 days to collect payments from its customers. This figure reflects the average time to turn PIA sales already shipped and billed to the customers into cash. The PIA's accounts receivable collection days has been relatively healthy, ranging from 39 to 45 days during the past three years. Most of the PIA's customers pay invoices via direct transfer by the State Controller's Office, a procedure that helps speed the collection of accounts receivable from state agencies.

We compared the PIA's average collection days against industry medians published by Robert Morris Associates in its *Annual Statement Studies 1995* (RMA report). The RMA report provides comparative financial data for thousands of companies in over 100 industries. We identified the median collection days for 2,625 companies operating in 19 industries similar to the PIA's 12 largest industries. We then determined that the average for all 19 industries was approximately 44 days, exactly the average for the PIA during fiscal year 1994/95.

Accounts receivable are idle assets. Until they are collected from customers, they generally do not provide much benefit to an entity. If an entity does not manage its accounts receivable, it may have to borrow funds and incur finance charges just to maintain adequate operating cash flow levels. Because the PIA effectively managed its accounts receivable, the PIA optimized its earnings on accounts receivable, even while sales and billings were growing 12 percent from the prior fiscal year.

**The PIA Has a
Sophisticated
Manufacturing
Information
System**

In 1990, the PIA began selection and implementation of an information system to manage its diverse manufacturing operations. The Manufacturing and Accounting Planning System, or MAPS, is a centrally operated system which allows the PIA to, among other capabilities, enter and track customer orders, prepare master schedules for production in each factory, purchase raw materials, manage inventory, track standard and actual costs, and monitor accounts payable and accounts receivable. As presented in a December 1989 report to the PIA, the system is designed to help the PIA reduce inventory levels, adhere to production schedules, significantly improve customer service, and provide valid and timely management information.

To avoid the risks of custom development, the PIA chose a software package already available on the market. With approximately 275 workstations now deployed by the PIA across the state, managers have a system to help manage production schedules, production costs, inventory levels, raw material needs, and warehousing. Prior to MAPS, nearly all this work was performed manually, resulting in untimely cost information, lack of production efficiency data, unknown inventory quantities, and inadequate management performance reporting.

The system allows factory personnel to track and record how many hours inmates spend on any specific order so that the PIA can determine direct labor hours for a product. This important information is needed to determine the full cost of production for each product, factory, and industry.

As pointed out earlier in this report, inventory levels have been reduced since before MAPS was implemented, including work-in-process, a specific performance improvement established for MAPS. According to the PIA, the accuracy of inventory counts is now up to 98 percent, and the time it takes to process a customer's order has been reduced.

There remains considerable work for the PIA to do in order to leverage the capabilities provided by MAPS. The PIA must:

- ☐ Complete implementation of shop floor control to allow for detailed tracking and analysis of all production runs
- ☐ Correct the information used for labor and overhead rates for all products to ensure costs are accurate and reliable

-
- ☐ Provide complete monthly budget-to-actual reports which includes raw materials
 - ☐ Routinely analyze and resolve variances between actual and standard costs
 - ☐ Implement selected remaining MAPS modules which the PIA already has purchased, in particular, the forecasting module
 - ☐ Establish benefits and improvement goals for MAPS
 - ☐ Provide additional training to users in both materials requirements planning and on how to access and utilize MAPS effectively.

Chapter 5 ***Statutory and Regulatory Issues Adversely Affect the Prison Industry Authority's Operations***

The Prison Industry Authority is guided by enabling statutes from 1982, Penal Code Section 2800, et.al. These statutes develop the framework under which the PIA is managed and operated. In this chapter, we discuss how the statutes are contradictory and that PIA managers have made different interpretations of the statutes over time and often at the same time.

While the underlying statutes are contradictory, PIA managers have constantly redefined the internal operating mission statement to meet changes in PIA legislative and economic operating environment. At times, the mission has been stated to improve profitable enterprises, provide a maximum number of inmates with training and work experience, and meet and surpass the expectations of PIA customers. The result is a lack of a clear and consistent, long term mission and direction.

Statutes also established the Prison Industry Board, in theory, to have all the powers, and perform the same duties, as a board of directors of a private corporation. However the Prison Industry Board does not effectively monitor the PIA operations. The board is not independent, provides insufficient input to PIA policy, and performs a weak budgetary review of the PIA.

In this chapter, we discuss these issues and provide an example of what can go wrong when the CDC, the board, and/or the Legislature make maximization of inmate employment their primary consideration. After nearly 10 years, \$17 million, and considerable transformation, the textile mill at R. J. Donovan Correctional Facility has finally begun production. The State may never recover its investment in the plant, and the plant may continue to operate at a loss and may never be able to produce fabric at a cost at or below market prices for comparable fabric.

The PIA Has Contradicting Governing Statutes

The PIA is governed by Sections 2800, et. al., of the California Penal Code. This 1982 Statute, as amended over time, created the PIA. This governing statute is partially responsible for causing confusion over PIA performance and accountability. Also, the multiple and conflicting statutory purposes has made it virtually impossible to hold PIA managers strictly accountable for performance.

Section 2801 of the Penal Code states three purposes of the PIA:

- ❑ "To develop and operate industrial, agricultural, and service enterprises employing prisoners" (provide employment)

-
- ☐ "To create and maintain working conditions within the enterprises as much like those which prevail in private industry as possible, to assure prisoners employed therein the opportunity to work productively, to earn funds, and to acquire or improve effective work habits and occupational skills"
(develop work skills)
 - ☐ "To operate a work program for prisoners which will ultimately be self-supporting by generating sufficient funds from the sale of products and services to pay all the expenses of the program, and one which will provide goods and services which are used by the Department of Corrections thereby reducing the cost of its operation" (be self-supporting and help assist CDC).
(summary underlines added)

Section 2808(h) states that the PIA board shall have the power to "operate as a self-supporting organization, to provide as much employment for inmates as feasible, and to provide diversified work activities to minimize the impact on existing private industry in the state."

Over time and often at the same time, different PIA managers have made different interpretations of the statutes, and have interpreted statutes as directing the PIA to:

- ☐ Employ as many inmates as possible
 - to reduce idleness in state prisons and help alleviate tension and violence as part of the CDC mission
- ☐ Train as many inmates as possible in private sector job skills
 - to provide employment opportunities to inmates after their release so as to reduce recidivism
- ☐ Maintain break-even economics
 - to operate within an annual self-sustaining budget
- ☐ Be profitable
 - to be an entrepreneurial state activity
- ☐ Reduce costs of operation at the Department of Corrections
 - to increase efficiency of the CDC and to support CDC operations
- ☐ Ensure that its products are primarily sold only to state agencies, local governments, and foreign counties
 - to not have an adverse competitive impact on California industry.

Prior studies have pointed out significant inconsistencies in the above conflicting mission statements.¹ We present examples of inconsistent and conflicting objectives below.

Meeting inmate employment goals through labor intensive means can conflict with goals to provide improved occupational skills, be self-supporting, and/or reduce overall CDC costs. However, using state-of-the-art, capital-intensive technology to maintain break-even economics may hinder employment objectives. Using inmates who are sentenced to life in prison lowers opportunities for transferring relevant job skills to the private sector.

If the PIA goes beyond a self-supporting operation to one of profitability, then the PIA may not increase inmate employment, and it may increase costs to State agencies. Generating a profit within a restricted government market simply transfers funds from a state agency customer to the PIA at the expense of the customer. If the PIA improves the cost effectiveness of its operations, then these reduced costs should be passed indirectly to State customers in the form of reduced prices. If profits are obtained by increasing prices, then the PIA would not be competitive with the private sector, and it could negatively impact State customers.

The underlying penal code statute has been consistently contradictory in its intent over the past decade. Meanwhile, the internal operating mission of the PIA has been constantly redefined by PIA management to meet changes in the PIA political and economic operating environment. The result is a lack of a clear, and consistent, long-term mission and direction.

**The PIA Has Ever-
Changing Internal
Mission
Statements**

As of October 12, 1995, the PIA presented its most recent business (non-statutory) mission to be as follows:

“Through the use of inmate labor, we will meet or surpass the expectations of our customers by providing timely delivery of competitively priced, quality goods and services.”

Three specific current internal goals are:

- ☐ Customer focus/satisfaction
- ☐ Highly motivated, efficient workforce
- ☐ Sustain profitability.

Finally, four internal strategies to obtain the goals are:

- ☐ Develop a best value waiver process

¹ MGT Consultants, *Prison Industries Management Study*, May 1, 1990, page 8, and Little Hoover Commission, *California's \$4 Billion Bottom Line, Getting Best Value Out of the Procurement Process*, March 1993, page 140.

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- ☐ Narrow focus of products and services
 - ☐ Achieve competitive prices
 - ☐ Fully implement the make-to-stock inventory program.²

As pointed out by PIA management, the purpose of the PIA was originally founded upon penalogical needs, not monetary interest. Management claims that their current *sustain profitability* goal is to “generate sufficient funds from the sale of goods and services to pay all expenses and provide a return to meet future investment needs.” However, the PIA also points out that, historically, their cash position has not been sufficient to implement a reinvestment strategy. The PIA’s current mission statement appears to be more of a “break-even economics” goal (versus a true operate-at-a-profit goal); however, the PIA still uses the “profitability” term in their statement of goals.

The PIA management claims that, unlike private sector companies, they do not exist only to make a profit. The PIA uses the example that, if one PIA enterprise employs 300 inmates and loses \$1 million, while one other enterprise employs 20 inmates and makes at least \$1 million, then 320 inmates are employed while the PIA meets its goal of being self-supporting. With this example, the PIA is pointing out that their statutes do not require that each of their industries be self-supporting, but only that the overall organization be self-supporting.

PIA management also claim that in the last two to three years, they have changed their focus to more emphasize profitability versus employment. Management points out that in the past few years they have closed enterprises which were not profitable, most notably, fiberglass and micrographics.

Up until just a few months ago, the PIA mission was stated as follows:

“We are continuously committed to meeting or surpassing the needs and expectations of all our customers by developing, operating, and improving profitable enterprises which will produce, sell, and deliver quality goods and services on time. We will:

- “Employ California prison inmates in a business-like environment which will provide them the opportunity to acquire and practice effective work habits and occupational skills
- “Provide an environment where inmates and staff have the opportunity to use their diversity and creativity to realize their potential through personal and team excellence

² October 12, 1995, internal State of California, Department of Corrections, PIA Memorandum to all fiscal/materials management supervisors regarding the PIA mission/strategies.

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- “Foster professionalism and cooperation for the overall benefit of our customers and the PIA (underline emphasis added).”³

Just prior to this older mission statement, for several years the PIA’s mission statement read as follows:

“Employ California prison inmates in a private industry-like environment by:

1. “Producing and selling, at a profit, quality goods and services at competitive prices with timely delivery
2. “Maintaining a safe, clean, secure, and efficient environment that promotes work ethic
3. “Expanding markets and developing new products.”⁴ (underline emphasis added)

Finally, another older mission statement was as follows:

“Provide a maximum number of inmates with training and work in a safe, clean, and profitable environment. This will provide inmates with employable skills and a sense of work ethic while reducing costs of prison operations through cost avoidance and net profits to the system.”⁵ (underline emphasis added)

For the past ten years, the internal mission statement has been ever changing. It also has not been clearly or consistently communicated by management across the entire organization.

Many current PIA managers and staff still consider the overall mission of the PIA is to “put inmates to work.” This is a carryover message from the mid-1980s when one of the PIA’s primary focuses was to establish factories in new institutions to meet ambitious inmate employment goals. Today, the PIA is beginning to focus on new concepts such as “best value,” “customer orientation,” and “competitively priced products.”

Corresponding to the most recent PIA mission statement, the PIA General Manager told us that his number one goal now is to operate the PIA as a business and to focus on customer satisfaction. This is a relatively new and recent change for the PIA. A few years ago, the number one goal was inmate employment.

³ Undated PIA mission statement as articulated in most recent Five Year Business Plan for the Prison Industry Authority.

⁴ PIA Chairman’s James H. Gomez Report for Fiscal Year 1992/93.

⁵ MGT Consultants, *Prison Industries Management Study*, May 1, 1990, page 2.

The new PIA mission and goals are still not clearly articulated in the most recent mission statement, and it has not been clearly communicated within the organization. There is no clear consensus from all PIA managers what the PIA should, and could be because the messages regarding profitability and employment are mixed. We believe, along with some others, that the lack of clear communication of the PIA's mission and goals throughout the organization have significantly affected historical and current performance, accountability, and profitability.⁶

In summary, the PIA believes that it deals with pursuing a consistent mission by "pursuing the maximum employment of inmates, within the market constraints imposed, while sustaining a profitable business." However, there is nothing in the PIA's statutory purposes that says employment shall be maximized, nor that says the PIA shall operate as a profitable business.⁷

We believe that the PIA's most recent interpretation of statutes as reflected in its mission statement is somewhat confusing. We also believe that the mission statement still does not provide consistent and meaningful direction to measure PIA program and management performance.

We believe that the primary cause of these ever-changing mission statements are the stable, but contradictory underlying governing statutes. We also believe that a secondary cause is the inability, or unwillingness, of the Prison Industry Board and PIA management to set clear priorities and measurable objectives in their ever-changing operating environment, and then to lead the organization to meet these priorities.

With regards to this latter point, we acknowledge that the PIA has tremendous external legislative and economic pressures from both changing Legislative priorities and more demanding State customers. Nonetheless, we still believe that lack of direction on the part of the Prison Industry Board and management over the years has been a contributing factor.

**The Prison
Industry Board
Does Not
Effectively
Monitor the PIA
Operations**

The Prison Industry Board is not independent, provides insufficient input to PIA policy, and does not effectively monitor PIA operations. Most importantly, the board performs a weak budgetary review of the PIA.

In the PIA's own words, "the PIA maintains a symbiotic relationship with the CDC."⁸ The CDC purchases the majority of PIA products, the CDC supplies inmate labor that produces PIA products, and the chairman of the PIA's board is, by statute, the Director of the CDC.

⁶ MGT Consultants, *Prison Industries Management Study*, May 1, 1990, page 12.

⁷ Penal Code Section 2801 (Purposes) does not make any reference to maximizing employment. However, Penal Code Section 2808(h) (Powers and Duties of the Board) contains a reference "to provide as much employment to inmates as is feasible."

⁸ Five Year Business Plan for Prison Industry Authority, page 14, undated.

In accordance with statute, "the Chairman of the PIA shall be the administrative head of the board and shall exercise all duties and functions necessary to insure that responsibilities of the board are successfully discharged." The statute provides very broad authority to the Chairman of the Prison Industry Board.

In theory, the board is supposed to have all the powers, and perform the same duties, as a board of directors for a private corporation. However, the statute specifies that the board is allowed to hire the General Manager (GM) of the PIA, but only the PIA Board Chairman (CDC Director) is allowed to terminate the GM. The PIA GM is the Chief Administrative Officer of the PIA.

The CDC Director has appointing authority for all PIA staff, with the exception of the GM. The CDC Director also has terminating authority for all PIA employees, including the sole termination authority for the GM.

In practice, the CDC Director approves the hiring and firing of all PIA managers. The CDC Director has delegated to the PIA General Manager the authority to hire and terminate PIA non-manager staff. Also, the PIA GM sits as one member of the CDC Cabinet.

The board's organization raises questions as to who is ultimately responsible for policy administration of the PIA - the entire board or the CDC Director? The CDC Director has sole authority to fire the PIA GM and the CDC Director has sole authority to hire and fire PIA managers. Any PIA managers whom the GM wants to hire have to be directly approved by the Director of the CDC. The board has little effective input to PIA operations partly because of the dominant position of the CDC Director.

At the same time that the CDC Director is Chairman of the Board of the PIA, he also represents the PIA's largest customer (accounting for 57 percent of PIA sales), which presents a potential conflict of interest. The board is not one that is truly independent and broadly represents the general public, organized labor, and industry, although the Legislature may have intended it to be so (Section 2802 of the Penal Code).

Of the 11 member board, four are appointed by the Governor, two are appointed by the Senate Rules Committee, and two are appointed by the Speaker of the Assembly. One of the board members is a designee of the Secretary of Trade and Commerce Agency, one is a designee of the Department of General Services, and, finally, the Director of Corrections is an automatic member.

Historically, the board positions have been given relatively little attention or importance. This is because the appointments are: (1) not-compensated, (2) part-time assignments (the board is required to meet at least four times during each fiscal year), and (3) relatively obscure political positions in the State system.

Some board members readily acknowledge that the board is generally not proactive and often tends to provide minimal statutory participation. For example, the PIA's four new business strategies were not fostered by proactive board policy but by external stakeholder pressures, including concerns from State customers and the Legislature.

Most of the designated governmental appointees on the board have other full-time jobs. Some board members say they are detached from PIA operations because they are poorly informed due to inadequate briefings from PIA staff members at the infrequent board meetings.

Because the board is not truly independent and always effective, the PIA is not maximizing its effectiveness. The board should be an important body that has responsibility to: (1) appoint the GM and monitor performance of the GM, (2) oversee performance of PIA industries, and (3) set overall policy direction of the PIA. The board is not effective in these important functions.

The PIA is now a significant state organization with sales in excess of \$150 million a year, as well as many major long-term capital outlay projects that involve millions of dollars each. A finance committee of the board, consisting of all board members except the chairman, conducts the annual budget review. Despite requests from the performance audit team, a key budget committee member declined to be interviewed for this review because, as he said, "he had nothing new to contribute."

The board members do not conduct an in-depth analysis and evaluation of PIA's operating budget. The budget document that board members rely upon to pass judgment is lacking in sufficient detail, and some board members tell us that PIA staff do not brief board members in-depth concerning financial performance of the operation.

In the last few years the PIA has undertaken several major projects without proper board review and evaluation. These examples include the textile mill at the R.J. Donovan Correctional Facility, the automated manufacturing and accounting planning system, and the new make-to-stock warehouse.

As long as the PIA has no agency or departmental budgetary review, it is incumbent upon the board to perform a substantive budgetary review. One of the primary missions of the board is to review and approve an annual budget for the PIA.

**The PIA Is Not
an Authority
Independent From
the CDC**

The PIA is not an independent authority, nor do we believe it should be. The PIA operates in a complex and multifaceted environment, and CDC day-to-day custody issues will always take precedence over PIA program issues.

The PIA program operates within the four walls of the CDC. The PIA workforce is CDC inmates. Each PIA industry superintendent is ultimately responsible to the CDC warden at the institution for which the factory is

located. The PIA free-staff identification badge at the factory indicates CDC (not PIA). The majority of PIA sales are to the CDC. The Director of the CDC chairs the board.

A PIA site production manager stated to us that there is presently a “strange and strained” relationship between the PIA and the CDC. For example, though the PIA is supposed to be highly important to each individual CDC institution, managers of one PIA facility which we visited believed that the warden had not set foot within the PIA operation in five years. In some institutions, there is little sense of teamwork between the guards who work in PIA factories and PIA factory staff. Each organization knows of the need to work together, but each entity presently has its own unique culture, and the two organizations are not well integrated.

In effect, the PIA already is an informal subsidiary of the CDC. The present PIA board structure does not appear to provide the significant value to the PIA which the Legislature may have originally intended. The present structure with a separate CDC and PIA organization promotes a “we versus them” mentality and is not conducive to effective communications and operations. The PIA operation is neither a true business concern nor a true corrections program.

The benefits expected by the Legislature of an independent authority have not materialized. Civil service restrictions have hampered a true profit-making basis, and there have been few retained surplus earnings in the PIA revolving fund. Though statutes expressly state that the PIA can adopt personnel practices to meet unique needs of the PIA, including profit-sharing incentives, none of this has materialized as originally envisioned. In reality, the PIA does not have the ability to adopt its own personnel practices without a change to the State’s constitution regarding the civil service system. All PIA employees, except the General Manager and the Board Executive Officer, are still civil service staff.

The original legislative intent for an independent authority was to allow the PIA to run more like a business than a prison program. The concept of an independent board could make sense if the overriding mission of the PIA was to make a profit. We are suggesting that the legislative intent of the PIA should be one of an unsubsidized, self-supporting operation with customer and penal program benefits, rather than a for-profit business model.

Though the PIA is legally connected to the CDC now, it is not organizationally part of the CDC. Making the PIA a formal part of the CDC can help close the current organization and communication gap. It also will address some of the coordination gaps between the two organizations and allow the PIA to return to its core competency of serving the CDC and helping to make the CDC more self-sufficient. Finally, we believe that making the PIA organizationally part of the CDC should not necessarily add oversight or control features which would unnecessarily decrease flexibility of the PIA to run its unique manufacturing operation.

**The Textile Mill:
A \$17 Million
Example of How
the PIA's Current
Statutes and
Organization
Structure Do Not
Protect Taxpayer's
Interests**

Contradictory governing statutes, ever changing missions, and a board that does not always provide in-depth oversight creates a situation where the best interests of the taxpayers can get lost or overlooked in the pursuit of one goal versus another. We believe that the textile mill at the R.J. Donovan Correctional Facility is an example of what can go wrong when the CDC, the board, and/or the Legislature make maximization of inmate employment their primary consideration.

PIA management states that they were under intense pressure from the Legislature to provide employment at new correctional facilities beginning in the early to mid-1980s. Specifically, Chapter 1, Statutes of 1982, declared the Legislature's intent that all able-bodied prisoners be directed to work. Chapter 933, Statutes of 1985, added a provision to the Penal Code that mandated that at least 60 percent of the population of the Southern Maximum Security Facility at Tehachapi be employed in either PIA or vocational training. The CDC and/or the PIA interpreted this statute to apply to all prisons built after 1985. It was in this environment that the CDC, the board, and the PIA decided to build a textile mill at R.J. Donovan.

In 1985, the PIA began planning to build a highly complex and expensive textile mill to produce towels, sheets, and pillow cases for use by the CDC. The textile mill at R.J. Donovan is unusual in that it is a vertically integrated operation. In other words, the textile mill encompasses three different processes that one might find in three different factories. The first step in the process is to convert bales of cotton and polyester into finely twisted yarn (thread). The second step is to weave the thread into fabric. The third step is to dye the fabric the desired color. There is little precedence for this kind of business in California. In fact, according to the PIA, this facility is the largest vertically integrated textile mill west of the Mississippi River.

In 1985, the PIA estimated that the equipment needed would cost \$3.1 million and that the textile mill would employ 285 inmates. Even at this time, the PIA estimated that the textile mill would incur operating losses of \$366,000 during the first 12 months of operation.

One might expect that an undertaking of this magnitude, cost, and sophistication would undergo a great deal of study and scrutiny by the board and the PIA. However, we found that the PIA did not conduct a formal feasibility study for the textile mill. The only documentation the PIA could provide was a five-page proposal summarizing the project that the PIA presented at a public board hearing in August 1985. The proposal presented at the public hearing did not:

- ☐ Specify how long it would take to build the textile mill
- ☐ Provide an analysis of alternative technologies for the textile mill
- ☐ Provide a comprehensive cost/benefit analysis of alternatives of the selected textile mill design

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- ☐ Document the analysis and conclusions of what the market would be for the towels, sheets, and pillow cases
 - ☐ Provide an estimate of how much the building would cost
 - ☐ Present long-term projections of capital costs, operating income, and operating expenses
 - ☐ Describe the risks involved and what actions would be taken to mitigate these risks
 - ☐ Indicate that the textile mill would be built with inmate labor
 - ☐ Present a plan of organization to manage the project's construction, quality, risks, and costs.

Despite the lack of any detailed or structured feasibility study, the board approved the project. R.J. Donovan opened during fiscal year 1987/88 and construction on the textile mill began around 1989 using inmate labor. Under direction of a PIA-hired construction manager, the facility was completed more than three years later. This was not a turn-key construction project but rather an implementation that put together manufacturing equipment from all over the world, including the United States, Spain, and England.

By 1992, the facility began prototype test production. However, by the time the plant was built and in prototype testing, the PIA had already made a significant change in production plans. The PIA decided it was not economically viable for the plant to produce towels and linens as designed. Instead, the PIA decided that it would be more cost-effective for the plant to manufacture shirt and trouser fabric used by the PIA's cut and sew factories.

Because of the types of equipment already installed, the shirt and trouser material that this plant could make was different than the material the CDC had been using for years as standard inmate clothing issue. In order to complete the transition of this plant, the CDC eventually approved "feasible substitutes" of a new "mock" chambray shirt material (piece dyed versus CDC yarn dyed shirt) and a new lighter trouser material (8 ounce per yard versus CDC 10 ounce per yard denim jeans). The on-site PIA production management team should be commended for their efforts to physically transform this entire plant to produce shirt and trouser material. There were numerous technical problems to overcome so that this facility could handle a heavier material than the one for which it was originally designed for.

The plant did not begin producing shirt material for customers until 1993. There was little production in 1993 and 1994. By 1995, over five years since construction began, the plant began to operate more smoothly on a commercial scale. By the Fall 1995, the plant began making the trouser material in addition to the shirt material. Fully staffed, the textile mill only employs 130 inmates, far fewer than the original estimate of 285.

The actual costs of building and equipping the textile mill are much higher than originally projected by the PIA. The building cost over \$5 million and the equipment cost approximately \$7.6 million, exceeding the PIA's estimate of \$3.1 million for the entire project. In addition, the textile mill has incurred operating losses totaling \$4 million since 1993. In summary, approximately \$17 million of taxpayer funds have been invested in a textile mill that employs a relatively small number of inmates. Also, the textile mill may continue to operate at a loss and it may never be able to produce fabric at a cost at or below the market price for comparable fabric.

The PIA expects the plant to lose \$236,000 during fiscal year 1995/96. On-site management believes that their direct cost to produce shirt material is approximately \$1.60 per linear yard and that their direct cost to produce trouser material is around \$2.40 per linear yard. This material is sold to PIA factories at three CDC institutions for \$2.03 per yard for shirt material and \$3.04 for trouser material. The PIA's customers (the "cut and sew" factories at Tehachapi, Soledad, and Frontera) say that they can buy equivalent, or better, material from private vendors for \$1.50 per yard for shirts and \$2.60 per yard for trousers. The PIA expects that the plant will produce approximately 893,000 linear yards of shirt material and 1,000,000 linear yards of trouser material during fiscal year 1995/96.⁹

After nearly 10 years, \$17 million, and considerable transformations, this plant has finally begun full production. On-site PIA management should be commended for their hard work and successful efforts to turn this plant into an operating facility. From a broader policy perspective however, the fundamental question remains: At what cost was this project implemented and for what ultimate purpose? This project is very expensive, was poorly planned, has had relatively minimal employment impact, and continues to lose money.

While the current management of the PIA appear to be more inclined to study carefully a proposed new industry before proceeding, we are concerned that the same statutes and organizational structure that allowed the textile mill to proceed without careful analysis still exists. Unless the statutes governing the PIA and its organizational structure change, there is nothing to prevent a future management team, board, CDC director, or the Legislature from focusing on maximizing inmate employment without taking into consideration the net fiscal impact on the taxpayer. In Chapter 6, we discuss our recommendations for changes in the PIA's statutes and organizational structure .

⁹ One linear yard is equal to 60 inches by 36 inches.

Chapter 6 Recommendations

In this chapter, we describe the following recommendations to the Legislature in order to improve the efficiency and effectiveness of the Prison Industry Authority:

- ☐ The Legislature should clarify the statutes governing the PIA
- ☐ The Legislature should either make the PIA a Division of the CDC or reform the Prison Industry Board
- ☐ Both the California Department of Corrections and the PIA should develop the penal aspects of the PIA program
- ☐ The PIA should establish policies and practices to ensure that cost efficiencies are passed on to state customers, and that PIA prices do not exceed market prices
- ☐ The PIA should improve the management of its operations
- ☐ The California Department of Corrections should improve its operations that impact the PIA.

We present a discussion of these six recommendations in the text below. The first three recommendations address general policy issues, and the last three address operational issues raised in the report. To assist the PIA and the CDC, we provide more specific details regarding these last three operational recommendations at the end of this chapter. The purpose of this additional detail is to provide the PIA and the CDC with suggested approaches to implementing each of the operational recommendations.

The Legislature Should Clarify the Statutes Governing of the PIA

A fundamental conclusion of our performance audit is that the PIA lacks a clear mission and direction. The PIA's current operating mission statement does not address the basic contradictory problems which have significantly contributed to inefficient and ineffective operations over the years. To address concerns identified in this report, the Legislature should:

- ☐ Amend California state law to clarify the PIA mission. At a minimum, where current law has conflicting purposes, the Legislature should clarify its intent by setting priorities for specific purposes. Preferably, the Legislature would go even further and specify overriding objectives.
- ☐ Consider setting forth the conditions under which it expects the PIA to operate. Should the Legislature establish the penal aspects of the program as the PIA's objective, the Legislature should consider establishing the following conditions:

- Price all products and services at the full cost of producing the product and service. The PIA should sell its products at cost, and not “profit” from any of its state customers. PIA costs in this calculation should include all of the financial and economic costs and required reserves of operating this inmate work program, including interest, rent, and operations subsidies it currently receives
- Not sell any product at a price which is higher than the market price for a comparable product. The PIA should be allowed a reasonable range of a price differential, and be allowed a reasonable amount of time to realign pricing. Where the PIA industry is not-self-supporting because it cannot compete with the market pricing, the Legislature should require that the PIA: (1) reduce costs, (2) discontinue operations, or (3) seek an appropriation from the Legislature to allow that industry to continue employing inmates. The PIA should work with the Legislature to balance the penal benefits and costs of inmate employment for those industries which are not self-supporting.
- Meet customer needs through timely delivery of cost effective and quality goods and services. This principle would require that the PIA make quality products and services which are useful to the CDC and the State of California.

An effective and customer oriented operation may be the approach needed to sustain the PIA program over time without significant General Fund support, given the current environment of limited State resources and increasing demands placed on correctional programs. It is no longer sufficient that the PIA break-even financially but at a hidden increased cost to its state agency customers.

The PIA should be viewed as a penal program, but also one that must meet its customers’ needs and operate on a self-supporting basis. The PIA is beginning to manage its operations to “break-even.” Any “non-economic benefits” which justified a hidden subsidy in the past (such as promoting security goals of the CDC) must be internalized by bottom-line operating performance in terms of competitiveness, quality, break-even economics, or supplementary legislative funding.

- ❑ Adopt a cost-of-service model for the PIA. The PIA should focus on quality products, customer service, and providing the lowest possible prices to state customer agencies. If PIA prices can be lower than competitive prices, then the PIA is providing a direct benefit to its customers. Because the CDC is the PIA’s major customer, the PIA can help reduce the cost of the State and the CDC when prices are below market.

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- ☐ Acknowledge that the State of California has a fiduciary responsibility to provide goods and services to state agency customers in the most cost-effective manner. The PIA should specifically justify to the Legislature that the indirect, penal programmatic benefits of its non-self-sustaining industry work program exceeds the direct, budgetary subsidy from the general fund. It is possible that, for the PIA to maintain its current level of employment while selling its products at cost, the Legislature may have to subsidize the PIA by several million dollars a year.
 - ☐ Determine whether the programmatic benefits of the PIA justify the subsidies provided by the general fund.
 - ☐ Require an annual independent compliance audit as part of the annual financial audit process. The scope of this audit is to provide reasonable assurance that the PIA is complying with statutes, including any adopted by the Legislature as a result of this performance review. The compliance audit would determine that: (1) the PIA's cost accounting system is effective at measuring the full costs of production and overhead, (2) the PIA is pricing all products at full costs, and (3) the PIA has an adequate system in place to provide reasonable assurances that PIA prices are at or below market prices. This annual audit also should explicitly recognize and document any annual economic subsidies that the PIA receives.
 - ☐ Relieve the PIA from paying interest on loans from the general fund while the general fund borrows cash from the prison industries revolving fund. The amount of PIA debt on which interest is forgiven should be commensurate with the amount of cash borrowed by the general fund.
 - ☐ Make other statutory modifications, as necessary. At the same time that the Legislature clarifies the PIA mission, other modifications to the statutes may be needed, as suggested below in this report. If the Legislature changes the PIA's goals, then a package of corollary statutory changes may be necessary in order to help enable the PIA to operate more effectively.

**The Legislature
Should Either
Make the PIA a
Division of the
CDC or Reform the
Prison Industry
Board**

The Legislature should establish clear accountability for the PIA's performance with either the PIA's General Manager, the Director of the CDC, or the Board. In order to improve the accountability and structure of the PIA, the Legislature should consider the following alternatives:

- ☐ Eliminate the Prison Industry Board (PIB) in its entirety and make the PIA a division of the CDC; or
- ☐ Make the PIA a division of the CDC and retain the PIB with the primary responsibility for conducting public hearings and considering the

potential adverse impacts on California industry as a result of new PIA industries as currently required by the Penal Code, Section 2808; or

- ❑ Reform the PIB to make it more effective. Among the potential changes, the Legislature should consider the following:
 - Allow the majority of board members to elect a chair rather than the Director of the CDC automatically serving as chair
 - Allow the majority of board members to hire and terminate the General Manager
 - Allow the General Manager to hire and terminate his staff without interference from the board or the Director of the CDC
 - Increase expertise on the board in the areas of business, manufacturing, finance, accounting, and penal programs.

**Both the
California
Department of
Corrections and
the PIA Should
Develop the Penal
Aspects of the PIA
Program**

To address issues we have raised in this report, we recommend that the California Department of Corrections (CDC) and the PIA do the following:

- ❑ Begin to develop and implement penal program aspects of the PIA. Both the CDC and the PIA should immediately begin to more fully integrate the PIA penal program with the CDC mission. Both organizations then should measure and report resulting programmatic benefits of the PIA.

Inmates who work at the PIA, or participate in other CDC programs, earn credits, thereby reducing their sentence. The PIA and the CDC work functions need to be closely coordinated in this regard. The CDC should consider the consolidation of some non-profitable, but worthwhile, PIA industries (from a correctional perspective), with other CDC vocational instruction, academic education, and institutional support work assignments within the CDC. The PIA is one component of "inmate work," and at the least it should be coordinated more closely with these other programs.

- ❑ Both the CDC and the PIA should immediately begin to more closely coordinate and plan PIA business with CDC operations
- ❑ Undertake a systematic investigation of PIA inmate participation in terms of both correctional outcomes and effectiveness of the PIA process.

PIA inmate participation should be incorporated as a variable in the CDC's information system covering inmates under custody and inmates released. Information should be assessed routinely on the comparative experience of PIA participants and nonparticipants. In addition to industry participation indicators, more specific information on which PIA factory the inmate worked and type of job held, would enable the CDC to conduct more refined analyses of the effect of PIA participation. It may be that employment in certain factories or industries has more

beneficial effects in terms of post-release employment and recidivism than others. These kind of data would help enable the PIA to make decisions about the establishment of new industry operations.

- ☐ Examine periodically the relationship of prison industry participation and post-release employment. The CDC should explore coordination of this with the parole program so as to assess the comparative success of industry participants and nonparticipants in finding and holding jobs after release from prison.
- ☐ Develop and report on program outcome and process statistics. The CDC and the PIA should explore those features of the PIA experience which are particularly beneficial to inmate participants. What skills are inmates expected to acquire and do they acquire them? Does inculcation of the "work ethic" actually take place and does success vary from industry to industry? These and many other questions go to the heart of the PIA program process. Outcome and process information can provide the PIA with valuable input for making decisions about the future of new industry programs. This information requires a commitment on the part of the CDC and PIA to examine the PIA penal program on a periodic, systematic, and rigorous basis.

The PIA Should Establish Policies and Practices To Ensure That Cost Efficiencies are Passed On to State Customers, and That PIA Prices Do Not Exceed Market Prices

To ensure that the PIA addresses the concerns regarding efficiencies and effectiveness in this report, the PIA should take the actions identified below. In order to assist the PIA, we provided additional details for each of these actions at the end of this chapter.

- ☐ Implement new guiding principles
- ☐ Assign responsibility and accountability for profitability of each industry to a single individual
- ☐ Reduce administrative overhead
- ☐ Review and update labor and raw material standards used for each product focusing on direct labor hours
- ☐ Develop a method to allocate production overhead costs, based on the activity causing the cost
- ☐ Evaluate and resolve each month any significant variance between each product's standard cost and actual cost
- ☐ Adjust and update product labor and material standards every six months

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- ☐ Perform a comprehensive review of all PIA industries and products to determine which should be expanded, scaled back, or eliminated
 - ☐ Increase efforts to monitor competitor prices.

**The PIA Should
Improve the
Management of Its
Operations**

To ensure that the PIA addresses the problems identified in our report, it should take the actions below. We provide additional details for each of these actions at the end of this chapter.

- ☐ Reduce from six weeks to three weeks the time required to prepare and deliver month-end financial management reports
- ☐ Improve utilization of the manufacturing and accounting planning system (MAPS)
- ☐ Hire a cost accounting manager with extensive cost accounting experience and in-depth knowledge of cost accounting systems
- ☐ Develop and adopt a balanced scorecard of performance measures to ensure that execution at all levels in the PIA are consistent with the PIA's newly adopted strategies
- ☐ Select a cross-functional team to select the performance measures
- ☐ Develop incentives for employees when performance measures are met or exceeded
- ☐ Identify optimal production levels for each factory and then focus efforts to increase sales of products made by these factories
- ☐ Add clarifying information to the annual report to the Legislature
- ☐ Improve short-term (one year) forecast of customer needs
- ☐ Update customer unit sales forecasts at least quarterly, creating a moving and more current forecast of demand
- ☐ Pay rent to the CDC that is sufficient to recover the CDC's construction and maintenance costs of the rented facilities
- ☐ Recognize and report interest charges paid by the general fund for the PIA's contributed capital

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- ☐ Request reimbursement funding from the CDC for work performed by the PIA for the CDC
 - ☐ Identify other subsidies provided by the CDC or the general fund, and recognize these subsidies as a cost of operating the PIA
 - ☐ Survey at least once per year any customer that purchases more than \$100,000 of goods or services from the PIA during the year and determine its satisfaction with the PIA's cost, quality, and cycle time
 - ☐ Reduce average delivery times from 150 days to 90 days within one year, and to 60 days within two years
 - ☐ Order raw materials more frequently in smaller amounts
 - ☐ Increase the number of raw materials purchased under statewide contract
 - ☐ Provide each warehouse manager with written policies and procedures regarding inventory levels, standards for utilization of space, and materials management effectiveness. These policies and procedures are required by State Administrative Manual Section 3535
 - ☐ Develop a formal, system-wide policy for determining and disposing of obsolete, slow-moving, or excess inventory
 - ☐ Develop a formal plan to identify the planned uses of cash reserves
 - ☐ Change cash reserve policy from maintaining a two-month operating cash reserve to one month
 - ☐ Ensure that the Department of General Services fills the vacant PIA Buyer II position.

**The CDC Should
Improve Its
Operations that
Impact the PIA**

To ensure that the California Department of Corrections (CDC) addresses problems identified in our report, it should take the actions below. We provide additional details for each of these actions at the end of this chapter.

- ☐ Develop a statistically valid profile of inmate clothing requirements
- ☐ Develop the profile from a statistically valid random sample of inmates drawn from all new arrivals at CDC reception centers.
- ☐ Develop the general mix of the inmate population, by clothing sizes

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- ❑ Place one order (at or before the beginning of a new fiscal year) for all PIA products, including clothing, and request quarterly or monthly shipments.

The PIA and the CDC Should Consider the Following Suggestions To Implement the Operational Recommendations

In order to assist the PIA and the CDC in implementing the operational recommendations provided on the previous pages, we provide more details for each recommendation below. We repeat the specific recommendation in bold, then provide the suggested approach.

The Prison Industry Authority Should Establish Policies and Practices to Ensure That Cost Efficiencies Are Passed On to State Customers, and That Prices Do Not Exceed Market Prices

- ❑ **Implement new guiding principles.** Application of the recommended guiding principles should be made by the PIA, with or without, legislative clarification. Current statutes do not prevent implementation of most of these basic guiding principles. PIA management should prepare a plan to implement the recommended new statutory guiding principles, including:

- Develop a revised PIA mission statement
- Formulate new five-year goals and objectives with measurable criteria
- Prepare an inmate employment and training plan
- Implement revised pricing policies
- Perform product financial analyses and plans for self-supporting industries.

Adopting the self-supporting and market pricing standard would mark a significant departure from prior statutory interpretations and impact the basic components of the PIA organization and management philosophy. Though there are no quick fixes to resolve complex issues facing the PIA, this one recommendation would provide major benefits for setting a clear future direction for the organization.

- ❑ **Assign responsibility and accountability for profitability of each industry to a single individual.** This individual would be responsible for managing costs of production, establishing prices, and expanding or contracting the product line. One individual may be assigned responsibility and accountability for more than one industry.
- ❑ **Reduce administrative overhead.** The PIA should determine how to reduce non-production costs for sales, general, and administration from its current level of 13.6 percent of annual sales. The PIA also should recognize that some of these costs are direct costs of production (e.g., the Waste Management Division is responsible for one facility).

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- ❑ **Review and update labor and raw material standards used for each product, focusing on direct labor hours.** This review should include the following:

- *Standard Production Labor Hours and Costs* - Verify through time studies the number of labor hours used for any product with annual sales greater than \$250,000 and produced at any factory where the difference between the PIA's estimated (or "standard") costs and actual costs exceeded 20 percent for fiscal year 1994/95. The results of these "time studies" then should be reconciled against the standard production hours and actual production hours as recorded in MAPS, confirming that all labor hours are accounted for (i.e., production times direct labor hours standards, plus indirect employee hours, should equal total annual inmate labor hours). The PIA then should update each product's standard inmate production hours in MAPS based on the results. The PIA also should perform these time studies for each new product as it introduces.

The PIA should continue to refine its shop floor control process. Shop floor control is an industry practice used by the PIA to measure and capture the number of hours inmates actually use to produce an order (and ultimately, a single product). Each day, the PIA should reconcile the hours which an inmate charges to orders with the number of hours for which the inmate will be paid. Actual production hours charged to a product should be summarized and entered into MAPS on a daily basis. The PIA then should verify that the daily order summary is correctly key-entered into MAPS to ensure that all production hours are accurately entered into the system.

- *Standard Material Usage and Costs* - Perform a thorough review of the actual amount of raw material used to manufacture a product for any product with annual sales greater than \$500,000. The PIA then should ensure that the exact quantity of material used for a product is accurately recorded on the bill of materials maintained on MAPS. The PIA also should use a consistent unit of measure for a specific material across all bill of materials. The PIA should determine that the unit of measure and current purchase cost of the raw materials used in each product are accurate, and ensure that MAPS is appropriately updated and internally consistent. This is especially critical in situations where one PIA product (e.g., mock chambray) is the raw material for another product (e.g., shirt). In addition,

the PIA should perform this process for new products as they are introduced.

Finally all freight charges and sales taxes paid by the PIA for a raw material should be directly allocated to the cost of that raw material rather than considered overhead and then allocated across all materials based on labor hours.

- ❑ **Develop a method to allocate production overhead costs, based on the activity causing the cost.** After improving the accuracy of product labor and material standards, the PIA should determine if: (1) certain selling, general and administrative expenses and production overhead costs at PIA facilities can be charged directly to a product, factory, or industry, and (2) the appropriate bases to allocate the remaining non-production and overhead costs to products. The objective is to reduce selling, general and administrative expenses and the total production overhead allocation pool by charging as many costs as possible directly to a specific product. For example, the PIA should allocate the costs of the waste management division, currently included in selling, general, and administrative expenses, directly to the material recovery facility (MRF) to the extent these costs relate to MRF activities. For a second example the salary of the San Quentin Ultra II ergonomic chair factory supervisor should be charged directly to the chairs rather than being allocated to all products made at San Quentin. The remaining line item costs which remain to be allocated, and have now been reduced, should be allocated to products based on what drives each line item cost. For a simple example, assume shirts and boots are stored in a finished goods warehouse. If shirts occupy 80 percent of the warehouse space used and boots 20 percent, then the PIA should allocate 80 percent of the warehouse costs to shirts and 20 percent to boots.
- ❑ **Evaluate and resolve each month any significant variance between each product's standard cost and actual cost.** This analysis should examine labor hours, labor cost, material usage, material cost, and applied overhead. PIA management should require factory managers to explain any cost variances which exceed a specific threshold within one week. For example, variances exceeding five percent must be explained to the comptroller (or designee) by the factory manager responsible for the product within one week from receipt of the monthly variance report. The manager's response should be written and fully explain the cause of the variance. The PIA should adjust the product labor and/or material standards if the standard is materially misstating the product's cost. Otherwise, the standard should be updated at the next standard setting period, which we recommend be once every six months.

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- ❑ **Adjust and update product labor and material standards every six months.** The PIA should consider historical costs, planned costs, production plans, and actual and estimated prices when updating standards. Additionally, the PIA should determine that standard labor and material costs are consistent among similar operations or factories. The facility administrator, branch manager responsible for the product, and the comptroller should approve updated labor and material standards.

 - ❑ **Perform a comprehensive review of all PIA industries and products to determine which should be scaled back or eliminated.** We suggest that the PIA consider the following criteria:
 - Less than \$1 million annual sales. This figure is consistent with the PIA's own criteria for establishing new industries
 - Core products that make-up less than two percent of an industry's annual sales
 - Discrete products that make-up less than five percent of a core product's annual sales
 - Products whose fully-loaded costs are ten percent above low market prices and for which the PIA does not obtain approval to fund the difference
 - Industries and products where management does not have sufficient expertise to produce a cost effective, quality product on-time.

 - ❑ **Increase efforts to monitor competitor prices.** The PIA should formalize a process to systematically identify and track prices charged by competitors for those products which produce 80 percent of the PIA's annual sales. This includes enhancing the PIA's current practices to include information which is updated at least once per year, a common format which shows low and average market prices for each product, and a database of competitor contacts. The PIA should prepare a report at least twice per year of major differences between PIA and competitor prices, and take action to address large differences.

The Prison Industry Authority Should Improve the Management of Its Operations

- ❑ **Reduce from six weeks to three weeks the time required to prepare and deliver month-end financial management reports.** Within two weeks after the end of each month, the PIA now has essentially all information needed for interim financial reports and budget-to-actual reports. The PIA fiscal services should prepare and deliver reports to field staff and central office managers within three weeks after the end of the month, and request that these managers provide explanations for any significant variances from budget within

one week of receiving the reports. In order to generate reports within three weeks, the PIA should:

- Integrate the PIA's two separate systems for fixed assets and accounts payable in order to reduce the time required to reconcile monthly changes in these assets
- Develop and implement the capability to electronically read payroll tapes received each month from the State Controllers Office so that the data can be used by the PIA. The goal is to eliminate manual data entry of the payroll information
- Delay by one month recording the minor amounts of monthly transfer invoices and billings provided by the Department of General Services. According to the PIA, these DGS transfers account for just \$200,000 to \$300,000 per month (of \$15 million average monthly expenditures) but arrive at the DGS up to 5 weeks after the close of the month. The PIA should prepare month-end management reports to include the DGS data from two months prior, and note that adjustments will be made in the following month. For example, to prepare a month-end report for June 1996, the PIA should use information which the DGS provided for May 1996
- Perform a preliminary close of the financial records at least twice per month, prior to performing the final close of the financial records after the end of the month. Doing so will allow the PIA to identify errors in financial data earlier, correct the problems sooner, and reduce the time needed to prepare the month-end reports.

□ **Improve utilization of the manufacturing and accounting planning system (MAPS).** In addition to the PIA's improving its processes for capturing, recording, and updating standard and actual costs of production, the PIA also should make the following enhancements to MAPS:

- Capture and report cycle times for:
 - Processing customer orders
 - Ordering and receiving raw materials from suppliers
 - Moving materials and products between plants (inter-industry transfers)
 - Producing and assembling products
 - Delivering products to customers
 - Invoicing and receiving payments from customers.
- Integrate unit sales forecasts with unit production plans

- Determine the value of raw material used in production by factory and product, then include this information on the monthly management reports which compare budgeted costs to actual costs for the prior month
- Generate monthly the number and disposition of customer complaints received
- Perform a post-implementation review.

- **Hire a cost accounting manager with extensive cost accounting experience and in-depth knowledge of cost accounting systems.** Additionally, the PIA should hire at least two staff with significant training and experience in cost accounting methodologies and systems. The cost accounting positions should not necessarily increase the total number of positions in the fiscal services department. These three new positions could be created and filled by: (1) eliminating currently authorized but vacant positions, (2) replacing other positions through attrition, and (3) streamlining existing fiscal services activities to free up budgeted resources.

- **Develop and adopt a balanced scorecard of performance measures to ensure that execution at all levels in the PIA are consistent with PIA's newly adopted strategies.** The measures should provide a clear performance target or focus attention on critical areas of the PIA such as customer value, operational efficiencies, inmate employment, and financial results. The complexity of the PIA's operations requires that its employees: (1) be able to view performance in several areas simultaneously, (2) identify leading indicators of financial results, and (3) be held responsible and accountable for specific performance. The PIA should consider the following performance measures, then validate and adopt no more than ten measures (suggested targets are provided in parentheses):

- *Customer Perspective* -- how do customers view the PIA:
 - Number of customer complaints (10 percent lower than year before)
 - Time to resolve customer complaints (99 percent within one week)
 - Customer satisfaction ratings (receive highest satisfaction rating from at least 40 percent of all customers; be considered better than other suppliers by at least 50 percent of all customers)
 - Percent of on-time deliveries (99 percent)
 - Average delivery time (60 days)
 - Order accuracy (99 percent)
 - Order/unit fill rates (99 percent)
 - Competitive prices for all products (same or lower price than available market price)

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- *Internal Perspective* – what must PIA excel at:
 - Order fulfillment cycle time (reduce by 30 percent the time between receipt of a customer's purchase order and receipt of that customer's payment)
 - Ability to predict customer demand (10 percent forecast error)
 - Product quality (three percent return and rejection rate)
 - Inventory turns (six turns per year, or 60 days of inventory on-hand)
 - Inmate and employee productivity (\$25,000 sales per inmate, \$200,000 per free staff)
 - Inmate employment (7 percent of inmates housed, the national average)
 - Scrap reduction (reduce scrap by factor of ten over the next four years)
 - *Innovation Perspective* – can PIA continue to improve and create value:
 - Product focus (20 percent of products equal 80 percent of annual sales)
 - Number of new standard products developed and introduced (30 percent of annual sales from new standard products introduced in last three years)
 - Ideas generated (50 manufacturing improvement ideas submitted and implemented during year)
 - Training hours (minimum of 25 hours per year for each free staff employee)
 - Number or percentage of PIA inmates acquiring jobs within one year after release (70 percent)
 - Number of PIA inmates receiving training certificates (70 percent)
 - *Financial Perspective* – is the PIA self-supporting and reducing costs of the CDC:
 - Gross margin on a product (12 percent gross margin)
 - Selling, general, and administration non-production costs as a percent of sales (less than 12 percent)
 - Sales growth (match projected growth rate of inmates housed by the CDC)
 - Sales to non-State of California Customers (15 percent of annual sales)
 - Invoicing errors (none)
 - Days of accounts receivable (45 days).

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- ☐ **Select a cross-functional team to select the performance measures.** The team should have significant knowledge about all aspects of the PIA. The team should identify the PIA's basic business processes, such as "new product development," "order fulfillment," "customer service," and "gaining new business." The team then should develop and validate measures for how the PIA should work. The team will also need to develop an education and communication plan, and then train all employees about the balanced scorecard of performance measures. Finally, the PIA should prepare and distribute a one-page report each month which presents the most recent values of each measure.
 - ☐ **Develop incentives for employees when performance measures are met or exceeded**
 - ☐ **Identify optimal production levels for each factory and then focus efforts to increase sales of products made by these factories.** This should increase economies of scale (cover more of the fixed capital costs), utilize existing equipment more efficiently, and leverage PIA free staff with more inmate labor.
 - ☐ **Add clarifying information to the annual report to the Legislature.** Although the PIA's annual report to the Legislature meets minimum requirements of statute, the report does not provide any information to determine if the PIA is meeting these two of three statutory purposes: improving inmate work habits and occupational skills, and reducing the costs of the CDC's operation. The annual report contains insufficient information to measure the third of three statutory purposes, which is employ inmates. In order to provide sufficient and meaningful information to the Legislature to assess the extent to which the PIA is meeting its statutory purposes and is an effective penal program, the PIA should add the following information to the report:
 - Mission and purpose
 - Strategies and measurable objectives
 - Percentage of inmates housed by the CDC who are employed by the PIA (full-time equivalents during the year and headcount at year-end), for both the current and prior year
 - Number of PIA inmates receiving training certificates for both the current and prior year
 - Number of PIA ex-offenders who obtained jobs and the number of PIA inmates released during the same time period, for both the current and prior year
 - Number of free-staff employed (full-time equivalents), for both the current and prior year

- Savings to CDC operations resulting from PIA operations (e.g., prices below market)
- All costs of operating the program, including subsidies received (e.g., capital contributions, rent, revenue on products with prices above full costs), and subsidies provided to the CDC (e.g., completing inmate time cards)
- Net margin by industry (the difference between total industry revenues and total industry costs, including allocated share of non-production costs for selling, general, and administration)
- Satisfaction of customers with the PIA's prices, quality, and cycle times, based on annual survey of customers
- Specific information regarding the development of new enterprises, including year enterprise will be activated, capital investments required, number of inmates to be employed, and annual revenues and costs expected in each of the first three years of operations.

☐ **Improve short-term (one year) forecast of customer needs.** The PIA should institute the following reforms:

- Assist the twelve state agencies that are required by statute to report annually to the Director of General Services and to the Chairperson of the Joint Legislative Budget Committee to prepare their individual reports which show prior fiscal year purchases and planned future use of products and services provided by the PIA
- Develop sales forecasts for product units, not just for product dollars. The PIA should prepare unit sales forecasts for at least those products which account for 80 percent of sales, then consider whether unit sales forecasts should be prepared for the remaining products (in addition to dollar sales forecasts). The resulting sales forecasts should be by month for the next 12 months, and clearly document the assumptions used to prepare the forecasts.

☐ **Update customer unit sales forecasts at least quarterly, creating a moving and more current forecast of demand.** The PIA should play an active role in assessing these major customer annual demand and delivery requirements, and develop revised unit sales forecasts months before the products may be ordered by the customers.

☐ **Pay rent to the CDC that is sufficient to recover the CDC's construction and maintenance costs of the rented facilities.** The PIA should identify facilities it now rents from the CDC, the total square feet of these facilities, and the monthly charge which would recover the CDC's costs of constructing and maintaining these facilities. The

PIA then should negotiate new rents with the CDC which would recover the CDC's costs for these facilities.

- ☐ **Recognize and report interest charges paid by the General Fund for the PIA's contributed capital.** The annual interest expense on \$109 million of capital contributed to the PIA, which is now paid by the General Fund, should be reported in the PIA's annual report to the Legislature.
- ☐ **Request reimbursement funding from the CDC for work performed by the PIA for the CDC.** The PIA should determine the number of hours and the associated costs of performing routine, non-PIA activity for the CDC, then request that the CDC reimburse the PIA for these costs.
- ☐ **Identify other subsidies provided by the CDC or the General Fund, and recognize these subsidies as a cost of operating the PIA**
- ☐ **Survey at least once per year any customer that purchases more than \$100,000 of goods or services from the PIA during the year and determine its satisfaction with the PIA's cost, quality, and cycle time.** Responses to individual customer satisfaction surveys should be provided to the branch and factory managers of the products purchased by the customer. Each year, the PIA then should summarize results of all such surveys and provide the findings and conclusions to all employees.
- ☐ **Reduce average delivery times from 150 days to 90 days within one year, and to 60 days within two years.** To begin meeting these objectives, the PIA should:
 - Conduct a focused-improvement review of the order fulfillment process in order to reduce the time it now takes to process customer orders, order raw materials, deliver products, and get paid. The purpose of this effort is to:
 - Shift from the PIA's functional perspective (e.g., marketing, operations, fiscal services) to a cross-functional business process
 - Identify and then minimize or eliminate any activity which does not add value to the customer. A non-value added activity is any activity that could be minimized or eliminated without reducing the value to PIA's customers. Examples of PIA non-value added activities include confirming a purchase order with a customer, validating raw material requirements prior to developing a purchase estimate, rescheduling production, and key entering payroll information from the State Controller's Office.

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- Identify and implement process improvements to time and cost performance
 - Utilize the recommended unit sales forecast to prepare production plans and loadings of each factory
 - Encourage the CDC to plan properly for commonly required products (e.g., clothing), and place one annual order for each institution. This recommendation is discussed in more detail later, along with other recommendations for the CDC.
 - Evaluate and reduce out-of-stock rates and/or backorder levels for raw materials
 - Request that delegated authority to purchase raw materials without the Department of General Services involvement be raised
 - Evaluate production interruptions, rescheduling, and special expediting caused by work-in-process shortages
 - Analyze production variances to ensure that accurate time logs are considered in delivery schedules
 - Improve the quality and accuracy of each bill of materials
 - Calculate economic lot quantities for production to reduce costly set-up and increased lead time.
- ☐ **Order raw materials more frequently in smaller amounts.** The PIA should order smaller amounts of raw materials more frequently, and request that shipments be made when the factories need the material. This would help lower raw material inventory levels for items purchased under the PIA's delegated authority (under \$15,000), as well as for those purchased under statewide contracts (78 different raw materials, according to the PIA). For raw materials which must be procured through the Department of General Services, the PIA should place large orders and request frequent drop shipments from the suppliers.
- ☐ **Increase the number of raw materials purchased under statewide contract.** The PIA should identify whether any raw materials that are not already purchased under a statewide contract are eligible for such a contract. Items purchased from statewide contracts can generally be delivered to the PIA more quickly.
- ☐ **Provide each warehouse manager with written policies and procedures regarding inventory levels, standards for utilization of space, and materials management effectiveness. These policies and procedures are required by State Administrative Manual Section 3535**
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- ☐ **Develop a formal, system-wide policy for determining and disposing of obsolete, slow-moving, or excess inventory.** In order to reduce the estimated \$16 million in excess or obsolete inventory in PIA warehouses, the PIA should develop a policy which describes procedures for determining if an item is in excess, and various acceptable means for its disposal. Examples are intra-system transfers, secondary markets, or charitable donations. The plan should be sufficiently simple to implement so that PIA warehouse managers will use it, and be in accordance with State laws and regulations.
 - ☐ **Develop a formal plan to identify the planned uses of cash reserves.** In developing the plan, the PIA should consider the following:
 - Maximize return on cash reserves. For example, the PIA should pay-off long-term debt if the PIA's incremental borrowing rate exceeds the PIA's investment return from the Surplus Money Investment Fund
 - Improve infrastructure by replenishing inefficient and out-dated equipment
 - Develop a comprehensive analysis and plan for new products or industries at identified CDC institutions.
 - ☐ **Change cash reserve policy from maintaining a two-month operating cash reserve to one month**
 - ☐ **Ensure that the Department of General Services fills the vacant PIA Buyer II position.** This position, vacant since October 1995, processes all of PIA's purchase estimates and develops all purchase orders from these estimates. The PIA also should continue to work with the DGS and Department of Personnel Administration to upgrade the Buyer II position to an Associate Materials Analyst, the same classification as the second PIA buyer at the DGS. This change would allow both positions to be cross trained in all PIA buyer functions, providing uninterrupted service to the PIA when one buyer is unavailable (e.g., during vacation, sick leave, or training).

The CDC Should Improve Its Operations Which Impact the PIA

- ☐ **Develop a statistically valid profile of inmate clothing requirements.** The CDC should develop a profile of actual clothing needs for each institution, and then base its annual clothing order with the PIA on this profile. The profile would measure the distribution of inmates, by height, weight, and shoe size, and establish the distribution (or proportion) of inmates within each clothing and shoe size. That is, the percentages of inmates who wear a size 16 shirt, size 11 shoe, and 34 inch by 36 inch pair of Jeans.

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- ☐ **Develop the profile from a statistically valid random sample of inmates drawn from all new arrivals at CDC reception centers.** Because the height and weight of the inmate already is recorded by the CDC (using the CDC's automated offender-based information system), then only the shoe size need be obtained as additional information. Based on height and weight, the CDC then should develop the appropriate shirt, jacket, and pant size. For all inmates sampled, a frequency distribution should be developed showing the percentage of the total sample within each shirt size, jacket size, pants size, and shoe size.
 - ☐ **Develop the general mix of the inmate population, by clothing sizes.** The CPC's Operations Manual, Section 54090 (Inmate Clothing/Laundry Exchange Services), establishes procedures for issues, exchanges, laundry, and replacement of linen and clothing. This manual provides the specific complement of clothing items provided to each inmate. For example, a male inmate is provided three blue denim jeans, three chambray shirts, and four white T-shirts. The amount of clothing replaced each year is not established in the manual (except for certain female inmate items), but is left to each institution to determine. Using the profile of inmate sizes, the clothing complement, and projected prison population, the CDC should estimate the type and quantity of clothing needed for the fiscal year, for each institution.
 - ☐ **Place one order (at or before the beginning of a new fiscal year) for all PIA products, including clothing, and request quarterly or monthly shipments.** The information developed above should be used to place no more than one order per year, per institution, for clothing made by the PIA. The procurement officer at each CDC institution should be responsible for developing the order for a single institution.

Appendix A Employment and Sales at California Department of Corrections Facilities

Exhibit A-1, on the following page, shows PIA inmate employment over the past 12 years as compared to the CDC population. The exhibit also shows CDC population projections for the next six years.

At the end of June 1995, the California Department of Corrections operated 30 institutions. The Prison Industry Authority (PIA) operated factories in 23 of these, employing 7,012 inmates on June 30, 1995. **Exhibit A-2** lists the institutions in descending order of the percent of inmates housed which are employed by the PIA.

The value of goods sold by the PIA varies, as does the utilization of labor intensive processes at each factory. These variations can be reflected in the average dollar sales per inmate employed by the PIA. **Exhibit A-3** shows sales per inmate for each industry.

**PIA Inmate Employment and
CDC Actual and Projected Population**
(Fiscal Year Ending June 30)

	Actual											
Population	1984	1985	1986	1987	1988	1989	1990	1991	1992	1993	1994	1995
Total CDC Population (a)	42,119	47,075	55,238	64,737	72,121	82,872	93,810	101,995	104,352	115,534	124,813	131,342
Institutional CDC Population (b)	38,250	43,072	51,129	60,140	66,559	76,252	86,741	91,900	94,440	105,941	115,102	121,470
PIA Inmates Employed (c)	3,163	3,630	4,727	5,499	6,644	7,095	7,726	7,962	6,899	6,295	6,505	7,012
Number of Institutions (d)	12	12	12	15	18	19	20	22	24	26	28	30
Percent Employment for Total CDC Population	7.5%	7.7%	8.6%	8.5%	9.2%	8.6%	8.2%	7.8%	6.6%	5.5%	5.2%	5.3%
Percent Employment for Institutional CDC Population	8.3%	8.4%	9.3%	9.1%	10.0%	9.3%	8.9%	8.7%	7.3%	5.9%	5.7%	5.8%

- (a) Includes Institutions, camps, community correctional centers, and DMH State Hospitals. Source: "Monthly Population Reports," CDC Data Analysis Unit, June 30, 1984 - June 30, 1995 and "Population Projections," California Department of Corrections, Fall 1995.
- (b) Only includes Institutional CDC Population. Source: "Monthly Population Reports," CDC Data Analysis Unit, June 30, 1984 - June 30, 1995 and "Population Projections," California Department of Corrections, Fall 1995.
- (c) Source: PIA Annual Reports.
- (d) Source: "Monthly Population Reports," CDC Data Analysis Unit, June 30, 1984 - June 30, 1995.

	Projected					
Population	1996	1997	1998	1999	2000	2001
Total CDC Population (a)	146,390	163,695	179,737	196,680	214,963	232,386

- (a) Includes Institutions, camps, community correctional centers, and DMH State Hospitals. Source: "Monthly Population Reports," CDC Data Analysis Unit, June 30, 1984 - June 30, 1995 and "Population Projections," California Department of Corrections, Fall 1995.

Inmates Housed at California Department of Corrections Facilities and Employed by the Prison Industry Authority

(As of June 30, 1995)

Official Acronym	CDC Institution	Location	Population	PIA Inmates	PIA Percentage of Population
NCWF	Northern California Women's Facility	Stockton	776	212	27.3%
SOL	California State Prison, Solano	Vacaville	4,519	648	14.3%
FSP	Folsom State Prison	Represa	3,782	477	12.6%
CMC	California Men's Colony	San Luis Obispo	6,189	703	11.4%
CCI	California Correctional Institution	Tehachapi	5,733	650	11.3%
CTF	Correctional Training Facility	Soledad	6,130	664	10.8%
COR	California State Prison, Corcoran	Corcoran	4,890	480	9.8%
DVI	Deuel Vocational Institution	Tracy	3,319	315	9.5%
RJD	Richard J. Donovan Correctional Facility	San Diego	4,661	426	9.1%
ASP	Avenal State Prison	Avenal	5,665	479	8.5%
SAC	California State Prison, Sacramento	Represa	3,237	251	7.8%
CIW	California Institution for Women	Frontera	1,939	150	7.7%
MCSP	Mule Creek State Prison	Imperial	3,496	257	7.4%
CCWF	Central California Women's Facility	Chowchilla	3,623	177	4.9%
PBSP	Pelican Bay State Prison	Crescent City	3,628	173	4.8%
CIM	California Institution for Men	Chino	5,744	255	4.4%
SQ	California State Prison, San Quentin	San Quentin	5,463	233	4.3%
CAL	Calipatria State Prison	Calipatria	3,891	112	2.9%
LAC	California State Prison, Los Angeles County	Lancaster	4,051	112	2.8%
SCC	Sierra Conservation Center	Jamestown	3,771	122	3.2%
VSPW	Valley State Prison for Women	Chowchilla	884	19	2.1%
WSP	Wasco State Prison-Reception Center	Wasco	4,607	57	1.2%
CVSP	Chuckawalla Valley State Prison	Blythe	3,511	40	1.1%
23	Total PIA Facilities		93,509	7,012	7.5%
CRC	California Rehabilitation Center	Norco	4,805	0	0.0%
CCC	California Correctional Center	Susanville	3,929	0	0.0%
CMF	California Medical Facility	Vacaville	3,069	0	0.0%
CEN	Centinela State Prison	Imperial	3,939	0	0.0%
IRON	Ironwood State Prison	Blythe	3,881	0	0.0%
NKSP	North Kern State Prison	Delano	4,414	0	0.0%
PVSP	Pleasant Valley State Prison	Coalinga	3,181	0	0.0%
SRTA	Santa Rita County Jail	Pleasanton	743	0	0.0%
8	Total Non-PIA		27,961	0	0.0%
31	Total for all Facilities		121,470	7,012	5.8%

Sales Per Inmate
Prison Industry Authority
Fiscal Year 1994/95

Industry	Sales	Percent of Total	Number of Inmates	Sales per Inmate
Vehicle Reconditioning ⁽¹⁾	\$ 13,524	0.0%	0	N/A
Coffee Roasting	2,358,561	1.5%	20	\$ 117,928
License Plates	9,394,378	6.2%	92	102,113
Meat Cutting (Processing)	8,227,059	5.4%	94	87,522
Cleaning Products (Detergent)	2,158,255	1.4%	37	58,331
Precast Concrete	3,861,100	2.5%	70	55,159
Eggs	3,404,007	2.2%	62	54,903
Dairy/Farm (+ Milk Processing)	11,916,687	7.8%	256	46,550
Bakery	2,242,510	1.5%	54	41,528
Mattress	2,406,652	1.6%	65	37,025
Printing	4,890,275	3.2%	139	35,182
Shoes	6,464,156	4.2%	186	34,754
Metal Products	14,643,055	9.6%	455	32,183
Paper Products	685,099	0.5%	24	28,546
Chicken (Poultry)	2,524,912	1.7%	97	26,030
Optical	8,161,515	5.4%	314	25,992
Wood Products	13,631,527	9.0%	597	22,833
Bindery	2,814,182	1.8%	145	19,408
Knitting Mill	1,885,380	1.2%	102	18,484
Fabric	27,766,663	18.2%	1,689	16,440
Crops	796,666	0.5%	50	15,933
Furniture Assembly & Refinishing	2,400,644	1.6%	163	14,728
Laundry	13,953,152	9.2%	951	14,672
Metal Signs	315,882	0.2%	22	14,358
Silk Screening	180,645	0.1%	18	10,036
Key Data Entry	676,689	0.4%	78	8,676
Materials Recovery Facility	1,142,207	0.8%	137	8,337
General Fabrication	2,477,213	1.6%	325	7,622
Fiberglass	115,133	0.1%	16	7,196
Dental Lab	203,762	0.1%	32	6,368
Micrographics	527,479	0.3%	84	6,280
Weaving (Textile) Mill	1,770	0.0%	116	15
PIA Central Office	0	0.0%	25	0
Product Design and Development	0	0.0%	37	0
Support	0	0.0%	460	0
Total	\$ 152,240,739	100.0%	7,012	\$ 21,711

(1) The vehicle reconditioning factory was shut-down prior to July 1, 1994. Residual sales of \$13,524 are related to the closure of the factory.

Appendix B Twelve-Year Historical Financial Results

This appendix presents information on the financial history of the Prison Industry Authority (PIA). **Exhibit B-1**, at the end of this appendix, presents a twelve-year financial history of operations. **Exhibit B-2** presents the balance sheet for each of these twelve fiscal years. Finally, **Exhibit B-3** provides a number of activity, profitability, liquidity, and solvency ratios for each of the fiscal years.

Sales

Since fiscal year 1983/84, PIA sales grew at an annualized rate of approximately 13 percent, increasing annually except fiscal years 1991/92 and 1992/93. **Figure B-1**, below, presents PIA sales for the last twelve years.

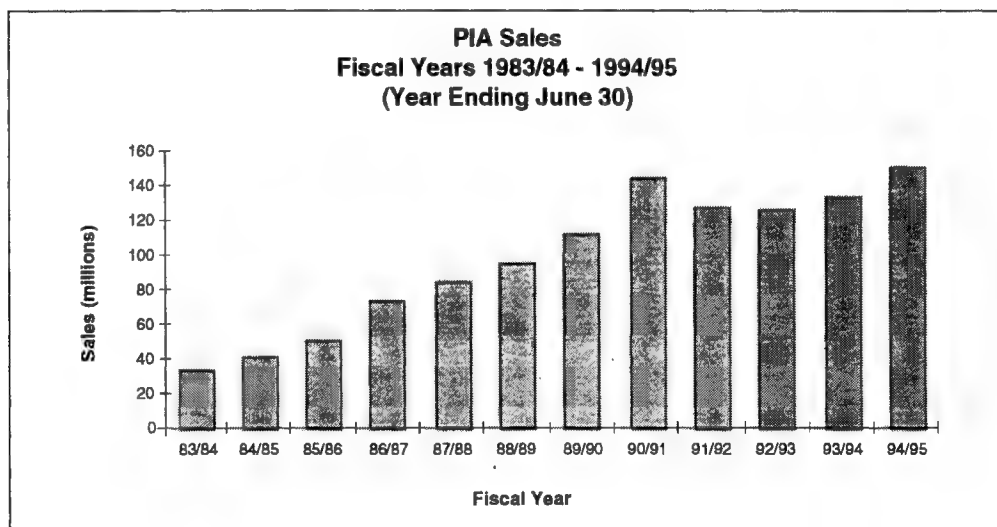


Figure B-1

The California Department of Corrections (CDC) is the PIA's major customer and accounted for approximately 57 percent of PIA sales in fiscal year 1994/95. The significant sales increase since fiscal year 1983/84 reflects the growth in inmate population, construction of new institutions, and expansion of existing, and establishment of new, industries by the PIA to provide the growing inmate population with work opportunities. The significant new industries established during this period include precast concrete, general fabrication, meat processing, optical, bakery products, coffee roasting, and chicken and egg production. Nearly 60 percent of the expansion of existing, and establishment of new, industries was funded with the issuance of 1986 general obligation prison construction bonds.

During this period inmate population increased approximately 200 percent, with the CDC adding new prisons since 1986. Sales peaked in fiscal year 1990/91 with sales increasing approximately 28 percent from the prior year. In fiscal year 1991/92, PIA sales declined approximately 12 percent as California State agencies curtailed budgets and purchases in reaction to the downturn in California's economy. Sales rebounded in fiscal years 1993/94 and 1994/95 as the CDC increased its purchases of PIA fabric and furniture products. The CDC was replenishing inventory levels depleted as its inmate population continued to rise while its prior years' budgets and purchasing were curtailed. Additionally, other California State agencies began increasing their purchases as the California economy began to firm up.

Gross Profit

Gross profit is the amount received from sales minus the cost of those sales. Cost of sales include the following costs:

- ☐ Director labor -- Direct labor is inmate labor which is applied directly to products through standard production hours and standard rates for each product.
- ☐ Direct materials -- Raw materials and manufactured components used to make a product. Costs for these are applied to products based on the PIA's assumed quantity of each material and component used and the standard cost per each unit of these materials.
- ☐ Overhead -- Overhead includes all other costs of the factory and PIA administrative offices at the institution. Included in overhead are the salaries and benefits of 614 PIA factory and administrative employees at the institution, depreciation, rents, utilities, maintenance, repairs, and other costs of the factory and PIA administrative offices at the institution.

Gross margin is calculated by dividing gross profit by sales. Evaluation of gross margin is particularly useful because it may indicate: (1) the PIA's ability to pass cost increases through to customers by raising prices, (2) shifts in the mix of more profitable or less profitable products, (3) changes in margins initiated by competition, or (4) changes in the PIA's operating efficiencies.

Since fiscal year 1983/84, gross margins have fluctuated year to year. Gross margins for fiscal years 1991/92 and 1992/93 were the lowest since fiscal year 1985/86 (see the Operating Income section below for the cause of lower gross margins).

In fiscal year 1994/95, gross margin approximated 20 percent, the best performance since fiscal year 1986/87. This resulted from higher prices for the PIA's products, as well as improving operating efficiencies. Of PIA's 31 core industries, 19 industries achieved a gross margin in excess of 14 percent while 8 incurred losses. Industries operated by the PIA for over ten years (mature industries) generally performed the best, most notably, fabric products and license plates with gross margins of 36 percent and 32 percent, respectively. Two industries incurring significant losses were the textile mill and general fabrication with losses of \$1.5 million and \$1.4 million, respectively. General fabrication revenue primarily consists of sales of Century 2000, a modular panel office system, which has been in production about two years. It is not unusual for mature industries to outperform new industries due to the length of time often needed to obtain operating efficiencies.

Operating Income

Operating income is gross profit minus selling and administrative expenses not included in cost of sales. Selling and administrative expenses include salaries and benefits of 159 PIA central office employees, travel, professional services, office supplies, and other expenses of the central office. During the twelve-year period, the PIA has generated operating income every year except fiscal years 1983/84 and 1985/86.

Operating margin is calculated by dividing operating income by sales. Operating margin indicates the PIA's operating profitability by measuring how much of expenses incurred by the PIA in carrying on its ordinary major activities are covered by sales. The distinction between gross margin and operating margin is that operating margin includes the effect of selling and administrative expenses on profitability. In fiscal year 1994/95, operating margin was approximately 6.2 percent.

As a percentage of sales, selling and administrative expenses have been fairly consistent throughout this twelve-year period rarely fluctuating by more than one percentage point on a year to year basis. During fiscal year 1994/95, selling and administrative expenses were approximately 13.8 percent of sales.

Although the PIA initiated efforts to reduce capacity and close certain unprofitable industries to weather the recession during fiscal years 1991/92 and 1992/93, management was unable to aggressively reduce its staffing levels. This was particularly due to certain limitations stipulated by California civil service rules; consequently, the PIA was unable to substantially reduce employee-driven operating expenses which contributed to lower gross profit and operating margins.

Other Income and Expenses

Other income and expenses include those items not considered to be directly related to the ordinary activities of producing and selling products and services. Below is a description of the significant components of these other items during the last twelve years.

Interest Income

Over the last twelve years, total interest earned on cash was approximately \$10.9 million. The PIA's cash principally consists of deposits in the custody of the State of California Treasurer invested in the Surplus Money Investment Fund (SMIF). Interest earned on cash invested in the SMIF is prorated to the PIA based on its average daily balance. The PIA is not paid interest on money it temporarily lends to the State's General Fund.

Interest Expense

The PIA has borrowed money primarily from the State General Fund to finance new prison industry projects and from the Pooled Money Investment Board as advances to cover certain costs incurred by the PIA prior to receipt of \$62 million from the 1986 general obligation prison construction bond offering. Over the twelve year period, total interest expense incurred by the PIA was approximately \$17.4 million. These interest expenses do not include any interest on \$109 million of capital contributed to the PIA. This interest was paid by the State's General Fund.

Plant Start-Up Costs

Plant start-up costs are those one-time costs associated with the analysis, design, staff training, and information system integration of starting-up a newly established operation or process.

Over the last twelve years, total plant start-up costs were approximately \$18.9 million. Approximately two-thirds of this was incurred during fiscal years 1987/88 through 1989/90 as a result of expansion of PIA facilities at newly built institutions.

Net Income

Net income is operating income plus or minus other income and expenses. Since inception, the PIA generated net income of approximately \$20.9 million, even though net losses were incurred in six of these years. **Figure B-2**, below, presents net income and loss for the last twelve years.

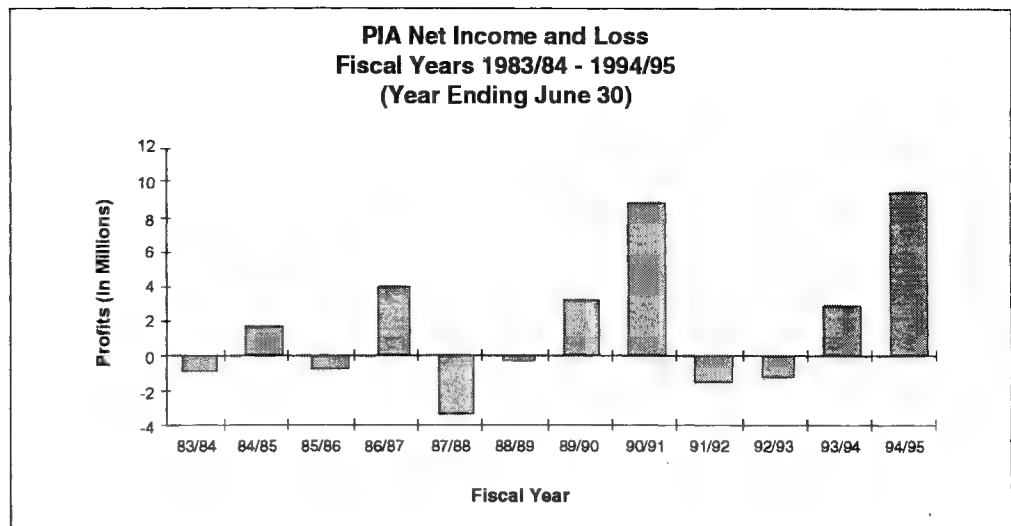


Figure B-2

Net profit margin is calculated by dividing net income by sales. Trends in net profit margin usually can be explained by analyzing corresponding trends in the PIA's operating margin, financing costs and plant start-up costs. In fiscal year 1994/95, the PIA's net profit margin was approximately 6.5 percent.

Operating and Total Return on Assets

Return on assets is calculated by dividing income by total assets. Return on assets indicates how much the PIA earns on each dollar of its assets. Exhibit B-3 indicates the return on assets on an operating income and net income (total return) basis. In fiscal year 1994/95, operating and total return on assets was approximately 5.9 percent and 6.1 percent, respectively.

Operating and Total Return on Equity

Return on equity is calculated by dividing income by equity and is a comprehensive measure of profitability that indicates the rate of return generated by the PIA's equity. Return on equity is the result of the combined effects of the management of resources and operations. Exhibit B-3 indicates the return on equity on an operating income and net income (total return) basis. In fiscal year 1994/95, operating and total return on equity was approximately 7.3 percent and 7.6 percent, respectively.

Cash

The PIA invests its cash primarily in the Surplus Money Investment Fund (SMIF). Interest earned on cash invested in the SMIF is prorated to the PIA based on its average daily balance.

During the last twelve years, the PIA has generated approximately \$52.6 million in cash from operating activities. Cash provided by operating activities excludes financing activities (i.e., payments of principal and interest on debt, and proceeds from borrowing and capital contributions) and investing activities (i.e., acquisitions of property and equipment, proceeds from sale of property and equipment, and interest received on cash invested in the SMIF). Cash consumed by investing and financing activities during this period approximated \$26.9 million. In total, through operating, investing and financing activities, the PIA's cash balance has increased by approximately \$25.7 million since June 30, 1983.

Average Collection Period of Accounts Receivable

When PIA delivers a product, it invoices the customer and waits for payment. The invoice creates an account receivable. In fiscal year 1994/95, it took an average of 44 days for the PIA to receive payment for its invoices. During the twelve-year period, the average collection period ranged from 24 days in fiscal year 1985/86 to 59 days in fiscal year 1991/92. The median of over 2,600 companies operating in 19 industries is 44 days of receivable.¹ Historically, the PIA generally has not had any material losses from its receivables.

Due from State Funds

Due from state funds represents amounts owed to the PIA from the State General Fund and other state funds. Amounts due from the State General Fund consists principally of PIA funds transferred from the Surplus Money Investment Fund by the California State Controller to the General Fund in the Treasury pursuant Government Code Section 16310. The PIA is not paid any interest on amounts it transfers to the General Fund. The body of this report provides an explanation of Government Code Section 16310 and an estimate of this lost interest income. Amounts due from other state funds principally relate to expenditures made by the PIA for construction which are to be reimbursed.

Inventory

At June 30, 1995, the PIA's inventory consisted of \$21.3 million of raw materials, \$8.2 million of work-in-progress and \$9.2 million of finished-goods. Raw materials are natural or semifinished goods that are used in manufacturing or processing to make some other good. Work-in-progress are the partially finished products of a manufacturing or processing concern. Finished-goods are products ready for sale to customers.

¹ Source: *RMA Annual Statement Studies 1995*, Robert Morris Associates, for fiscal year ending 3/31/95. The RMA report provides comparative financial data for thousands of companies in over 100 industries. For this PIA report, we obtained historical median performance for 2,625 companies in 19 industries, including clothing, metal, wood, dairy, meat processing, optical, shoes, printing, concrete, and paper industries.

Inventory turnover is an overall indicator of inventory management and the liquidity of a company's inventories. For example, the average age of the PIA's inventory in fiscal year 1994/95 was 105 days. This means that it takes the PIA on average 105 days to convert inventory into sales. The average days in inventory has improved from 170 days in fiscal year 1984/85. The PIA operates 33 industries; accordingly, the average days in inventory varies considerably depending upon the particular industry. In the body of this report, we display the average days in inventory for the PIA's significant manufacturing industries and analyze the effectiveness of the PIA's inventory management.

Liquidity

Liquidity ratios are helpful to measure the PIA's ability to meet its current obligations with current assets as they become due. The liquidity ratios on Exhibit C-3 indicate that the PIA can satisfy current obligations with current assets as they become due.

The current ratio is calculated by dividing current assets by current liabilities. Most analysts hold that for a manufacturing company the minimum current ratio should be 2 to 1, that is, current assets should be at least twice as great as current liabilities. At June 30, 1995, the PIA's current ratio was 4.1 to 1.

The quick ratio is calculated by dividing current assets, excluding inventory, by current liabilities and measures the extent to which current liabilities are covered by highly liquid assets. A quick ratio of at least 1 to 1 is normally considered satisfactory. At June 30, 1995, the PIA's quick ratio was 2.3 to 1.

Equity

Since the PIA's inception in 1983, capital in the amount of \$108.8 million has been contributed to the PIA. The PIA received \$62 million of this from proceeds of 1986 general obligation prison construction bonds, \$17.5 million from the transfer of assets from the Corrections Industry Revolving Fund, \$12.2 million from the California Department of Corrections, \$8.1 million from the Public Building Construction Fund, and \$9 million from other State sources. The PIA has not been required to pay interest on contributed capital.

With contributed capital, the PIA constructed factories at newly built institutions, most notably, California State Prison (CSP) Sacramento, CSP Avenal, CSP Corcoran, CSP Solano, Mule Creek State Prison, and Richard J. Donovan Correctional facility.

Retained earnings is the amount of net income the PIA has generated since inception in 1983.

Statement of Operations
Prison Industry Authority⁽¹⁾
(000s)

	1983/84	1984/85	1985/86	1986/87	1987/88	1988/89	1989/90	1990/91	1991/92	1992/93	1993/94	1994/95
Sales	\$35,361	\$42,619	\$52,531	\$75,946	\$86,447	\$96,490	\$115,016	\$147,094	\$130,071	\$128,578	\$135,750	\$152,241
Cost of sales	32,169	34,721	45,449	60,443	72,581	82,092	96,158	120,404	111,714	110,543	114,119	121,699
Gross Profit	\$3,192	\$7,898	\$7,082	\$15,503	\$13,866	\$14,398	\$18,858	\$26,690	\$18,357	\$18,035	\$21,631	\$30,542
Less: Selling and administrative expenses	\$4,960	\$6,387	\$7,142	\$9,512	\$11,332	\$12,029	\$14,359	\$17,582	\$16,978	\$17,588	\$17,553	\$21,075
Operating Income	(\$1,768)	\$1,511	(\$60)	\$5,991	\$2,534	\$2,369	\$4,499	\$9,108	\$1,379	\$447	\$4,078	\$9,467
Other income (expense):												
Interest income	\$251	\$124	\$799	\$762	\$418	\$1,484	\$2,464	\$1,094	\$502	\$342	\$813	\$1,834
Interest expense	0	0	(737)	(1,203)	(1,575)	(3,076)	(4,564)	(2,053)	(1,293)	(1,156)	(1,099)	(688)
Plant start-up costs	0	0	(659)	(1,562)	(4,425)	(5,096)	(2,099)	(1,615)	(1,795)	(715)	(514)	(372)
Loss on disposal of property and equipment	0	0	0	0	0	0	(178)	(1,241)	(582)	(494)	(295)	(409)
Refund from PERS ⁽²⁾	0	0	0	0	0	3,999	2,939	2,129	0	0	0	0
Other, net	48	167	(233)	140	(428)	44	338	1,837	66	147	7	63
Total Other Income (expense)	\$299	\$291	(\$830)	(\$1,863)	(\$6,010)	(\$2,645)	(\$1,100)	\$151	(\$3,102)	(\$1,876)	(\$1,086)	\$428
Net income (loss)	(\$1,469)	\$1,802	(\$890)	\$4,128	(\$3,476)	(\$276)	\$3,399	\$9,259	(\$1,723)	(\$1,429)	\$2,990	\$9,895

(1) Source: Audited Financial Statements. The first six months of PIA operation, January 1 through June 30, 1983, are not shown because audited financial statements were not available.

(2) Public Employee Retirement System

Balance Sheet

Prison Industry Authority⁽¹⁾

(000s)

	1983/84	1984/85	1985/86	1986/87	1987/88	1988/89	1989/90	1990/91	1991/92	1992/93	1993/94	1994/95
Assets												
<i>Current Assets:</i>												
Cash	\$2,852	\$2,337	\$4,178	\$2,149	\$6,105	\$5,074	\$1,155	\$10,279	\$2,782	\$18,259	\$22,186	\$30,252
Accounts receivable	3,483	3,246	3,717	6,861	7,211	10,210	18,753	23,701	18,959	13,735	15,488	21,742
Due from State funds	0	0	0	400	1,210	1,029	5,661	8,424	16,444	13,466	13,253	0
Inventories	15,056	17,737	19,262	23,066	27,819	29,078	35,095	35,877	35,352	32,900	32,272	38,714
Other	77	122	743	423	406	1,079	1,294	847	740	732	913	1,709
Total Current Assets	\$21,468	\$23,442	\$27,900	\$32,899	\$42,751	\$46,470	\$61,958	\$79,128	\$74,277	\$79,092	\$84,112	\$92,417
Property and equipment, net	\$3,963	\$4,303	\$7,388	\$16,524	\$40,747	\$53,781	\$58,263	\$65,545	\$68,226	\$74,056	\$69,535	\$68,089
Restricted assets for capital expenditures	0	0	11,614	22,090	22,622	30,517	10,556	1,861	4,846	1,402	733	857
Total Assets	\$25,431	\$27,745	\$46,902	\$71,513	\$106,120	\$130,768	\$130,777	\$146,534	\$147,349	\$154,550	\$154,380	\$161,363
Liabilities and Equity												
<i>Current liabilities:</i>												
Accounts payable and accrued liabilities	\$3,691	\$5,111	\$8,628	\$11,881	\$17,928	\$22,092	\$17,703	\$18,443	\$14,100	\$15,635	\$16,519	\$17,953
Due to State funds	353	353	1,390	1,034	1,101	1,099	1,034	948	1,909	1,956	1,527	1,396
Current portion of long-term debt	0	0	51	285	827	576	381	521	986	1,067	1,331	1,570
Current portion of workers' comp. reserve	0	0	0	0	0	0	0	1,120	1,309	1,059	971	810
Other	1,669	761	2,086	1,808	7,860	1,367	474	934	1,318	892	169	691
Total Current Liabilities	\$5,713	\$6,225	\$12,155	\$15,008	\$27,716	\$25,134	\$19,592	\$21,966	\$19,622	\$20,609	\$20,517	\$22,420
Long-term debt, net of current	\$0	\$0	\$14,117	\$13,770	\$13,986	\$14,463	\$12,983	\$12,462	\$15,126	\$14,059	\$9,716	\$3,588
Worker's comp. reserves, net of current	0	0	0	0	0	0	0	3,430	3,997	4,676	5,154	5,660
Bond fund advances	0	0	0	0	0	29,000	21,000	0	0	0	0	0
Total Liabilities	\$5,713	\$6,225	\$26,272	\$28,778	\$41,702	\$68,597	\$53,575	\$37,858	\$38,745	\$39,344	\$35,387	\$31,668
<i>Equity:</i>												
Contributed capital	\$18,500	\$18,500	\$18,500	\$36,477	\$61,636	\$59,665	\$71,297	\$97,525	\$99,176	\$107,207	\$108,004	\$108,811
Retained earnings ⁽²⁾	1,218	3,020	2,130	6,258	2,782	2,506	5,905	11,151	9,428	7,999	10,989	20,884
Total Equity	\$19,718	\$21,520	\$20,630	\$42,735	\$64,418	\$62,171	\$77,202	\$108,676	\$108,604	\$115,206	\$118,993	\$129,695
Total Liabilities and Equity	\$25,431	\$27,745	\$46,902	\$71,513	\$106,120	\$130,768	\$130,777	\$146,534	\$147,349	\$154,550	\$154,380	\$161,363

(1) Source: Audited Financial Statement

(2) Retained earnings were adjusted by \$4,013,000 in fiscal year 1989/90 to reflect prior period adjustments.

Financial and Operating Ratios Prison Industry Authority

EXHIBIT B-3

	1983/84	1984/85	1985/86	1986/87	1987/88	1988/89	1989/90	1990/91	1991/92	1992/93	1993/94	1994/95
Cash flow Summary (\$000s) ¹ :												
Provided (used) by operating activities	\$284	\$968	\$3,791	\$1,617	\$6,645	(\$3,020)	(\$9,792)	\$9,989	\$8,935	\$16,456	\$10,640	\$6,074
Provided (used) by investing/financing activities	(1,466)	(1,483)	(1,950)	(3,646)	(2,689)	1,989	5,873	(865)	(16,432)	(979)	(6,713)	2,115
Net Increase (decrease) in cash	(\$1,182)	(\$515)	\$1,841	(\$2,029)	\$3,956	(\$1,031)	(\$3,919)	\$9,124	(\$7,497)	\$15,477	\$3,927	\$8,189
Activity ratios:												
Inventory turnover per year ²	2.14	2.12	2.46	2.86	2.85	2.89	3.00	3.39	3.14	3.24	3.50	3.43
Average age of inventory (days) ³	168	170	147	126	126	125	120	106	115	111	103	105
Accounts receivable turnover per year ⁴	10.15	12.67	15.09	14.36	12.29	11.08	7.94	6.93	6.10	8.03	9.29	8.18
Average receivable collection period (days) ⁵	35	28	24	25	29	32	45	52	59	45	39	44
Profitability ratios:												
Increase (decrease) sales ⁶												
Cost of sales as a % of sales ⁷	91.0%	81.5%	86.5%	79.6%	84.0%	85.1%	83.6%	81.9%	85.9%	86.0%	84.1%	79.9%
Gross margin ⁸	9.0%	18.5%	13.5%	20.4%	16.0%	14.9%	16.4%	18.1%	14.1%	14.0%	15.9%	20.1%
Operating margin ⁹	-5.0%	3.5%	-0.1%	7.9%	2.9%	2.5%	3.9%	6.2%	1.1%	0.3%	3.0%	6.2%
Selling and administrative expenses as a % of sales ¹⁰	14.0%	15.0%	13.6%	12.5%	13.1%	12.5%	12.5%	12.0%	13.1%	13.7%	12.9%	13.8%
Net profit margin ¹¹	-4.2%	4.2%	-1.7%	5.4%	-4.0%	-0.3%	3.0%	6.3%	-1.3%	-1.1%	2.2%	6.5%
Operating return on assets ¹²	-7.0%	5.4%	-0.1%	8.4%	2.4%	1.8%	3.4%	6.2%	0.9%	0.3%	2.6%	5.9%
Operating return on equity ¹³	-9.0%	7.0%	-0.3%	14.0%	3.9%	3.8%	5.8%	8.4%	1.3%	0.4%	3.4%	7.3%
Total return on assets ¹⁴	-5.8%	6.5%	-1.9%	5.8%	-3.3%	-0.2%	2.6%	6.3%	-1.2%	-0.9%	1.9%	6.1%
Total return on equity ¹⁵	-7.5%	8.4%	-4.3%	9.7%	-5.4%	-0.4%	4.4%	8.5%	-1.6%	-1.2%	2.5%	7.6%
Liquidity ratios:												
Current ratio ¹⁶	3.8	3.8	2.3	2.2	1.5	1.8	3.2	3.6	3.8	3.8	4.1	4.1
Quick ratio ¹⁷	1.1	0.9	0.6	0.6	0.5	0.6	1.3	1.9	1.9	2.2	2.5	2.3
Solvency ratios:												
Long-term liabilities as a % of equity ¹⁸	0.0%	0.0%	68.4%	32.2%	21.7%	69.9%	44.0%	14.6%	17.6%	16.3%	12.5%	7.1%
Asset leverage ¹⁹	1.3	1.3	2.3	1.7	1.6	2.1	1.7	1.3	1.4	1.3	1.3	1.2

- (1) Source: Audited Financial Statement
- (2) Inventory turnover per year = (sales / total assets)
- (3) Average age of inventory (days) = (cost of sales) / (beginning inventory + ending inventory) / 2
- (4) Accounts receivable turnover per year = (sales) / (beginning accounts receivable + ending accounts receivable) / 2
- (5) Average receivable collection period (days) = (360 days / accounts receivable turnover)
- (6) Increase (decrease) sales = (current year sales - prior year sales) / prior year sales
- (7) Cost of sales as a % of sales = (costs of sales / sales)
- (8) Gross margin = (gross profit / sales)
- (9) Operating margin = (operating income / sales)
- (10) Selling and administrative expenses as a % of sales = (selling and administrative expenses / sales)
- (11) Net profit margin = (net profit / sales)
- (12) Operating return on assets = (operating income / total assets)
- (13) Operating return on equity = (operating income / total equity)
- (14) Total return on assets = (net income / total assets)
- (15) Total return on equity = (net income / total equity)
- (16) Current ratio = (current assets / current liabilities)
- (17) Quick ratio = (current assets - inventory) / current liabilities
- (18) Long-term liabilities as a percent of equity = (Debt + worker's comp. reserve + bond advances) / equity
- (19) Asset leverage = (total assets / total equity)

Appendix C Annual Sales and Profits, by Industry

The Prison Industry Authority sold \$152 million in goods and services in fiscal year 1994/95, and projects sales to increase six percent during fiscal year 1995/96 to \$162 million. Fabric products and general fabrication account for the largest increase in projected sales in fiscal year 1995/96. Notably, license plate sales are expected to decline by 16 percent to approximately \$8 million. The PIA expects a drop in unit sales, while prices for plates are expected to stay the same.

Exhibit C-1, on the following page, shows sales and relative share for each manufacturing, service, and agriculture operation during fiscal year 1994/95. The PIA is closing down the micrographics, fiberglass and vehicle reconditioning operations because of historically poor performance. Operations of the knitting mill are being combined and reported with fabric operations.

Exhibit C-2, following Exhibit C-1, shows actual fiscal year 1994/95 and projected 1995/96 sales and gross profits for each industry. Gross profits are the difference between sales and cost of those sales. Cost of sales include the following costs:

- ☐ Direct labor -- Direct labor is inmate labor which is applied directly to products through standard production hours and standard rates for each product
- ☐ Direct materials -- Raw materials and manufactured components used to make a product. Costs for these are applied to products based on the PIA's assumed quantity of each material and component used and the standard cost per each unit of these materials
- ☐ Overhead -- Overhead includes all other costs of the factory and PIA administrative offices at the institution. Included in overhead are the salaries and benefits of 614 PIA factory and administrative employees at the institution, depreciation, rents, utilities, maintenance, repairs, and other costs of the factory and PIA administrative offices at the institution.

From gross profits, the PIA must recover their selling and administrative expenses, which include salaries of PIA's 159 central office employees, travel, professional services, office supplies, and other expenses of the central office.

Sales by Industry
Prison Industry Authority
(Fiscal Year 1994/95)

Industry	Sales	Percent of Industry Sales	Percent of Total PIA Sales
Manufacturing			
Fabric Products	\$ 27,766,663	31%	18%
Metal Products	14,643,055	16%	10%
Wood Products	13,631,527	15%	9%
License Plates	9,394,378	10%	6%
Shoes	6,464,156	7%	4%
Precast Concrete	3,861,100	4%	3%
Bindery	2,814,182	3%	2%
General Fabrication	2,477,213	3%	2%
Mattress	2,406,652	3%	2%
Furniture Assembly & Refinishing	2,400,644	3%	2%
Cleaning Products (Detergent)	2,158,255	2%	2%
Knitting Mill	1,885,380	2%	1%
Paper Products	685,099	1%	0%
Metal Signs	315,882	0%	0%
Fiberglass	115,133	0%	0%
Silk Screening	180,645	0%	0%
Weaving (Textile) Mill	1,770	0%	0%
Manufacturing Subtotal	\$ 91,201,734	100%	62%
Services			
Laundry	\$ 13,953,152	33%	9%
Meat Cutting (Processing)	8,227,059	19%	5%
Optical	8,161,515	19%	5%
Printing	4,890,275	12%	3%
Coffee Roasting	2,358,561	6%	2%
Bakery	2,242,510	5%	1%
Materials Recovery Facility	1,142,207	3%	1%
Key Data Entry	676,689	2%	0%
Micrographics	527,479	1%	0%
Dental Lab	203,762	0%	0%
Vehicle Reconditioning ⁽¹⁾	13,524	0%	0%
Services Subtotal	\$ 42,396,733	100%	25%
Agriculture			
Dairy/Farm (+ Milk Processing)	\$ 11,916,687	64%	8%
Eggs	3,404,007	18%	2%
Chicken (Poultry)	2,524,912	14%	2%
Crops	796,666	4%	1%
Agriculture Subtotal	\$ 18,642,272	100%	13%
Total	\$152,240,739	—	100%

(1) The vehicle reconditioning factory was shut-down prior to July 1, 1994. Residual sales of \$13,524 are related to the closure of the factory.

Sales and Gross Profits
Prison Industry Authority
(Actual FY 1994/95 and Annual Plan FY 1995/96)

Product	Fiscal Year 1994/95			Fiscal Year 1995/96		
	Sales	Gross Profit (a)	Profit Margin (b)	Sales	Gross Profit (a)	Profit Margin (b)
Fabric Products	\$27,766,663	\$9,872,000	35.6%	\$35,845,000	\$11,956,000	33.4%
Metal Products	14,643,055	3,000,000	20.5%	15,213,000	3,813,000	25.1%
Laundry	13,953,152	2,092,000	15.0%	15,025,000	2,200,000	14.6%
Wood Products	13,631,527	3,179,000	23.3%	14,685,000	4,140,000	28.2%
Dairy/Farm (+ Milk Processing)	11,916,687	300,000	2.5%	11,478,000	478,000	4.2%
License Plates	9,394,378	3,046,000	32.4%	7,900,000	1,667,000	21.1%
Meat Cutting (Processing)	8,227,059	666,000	8.1%	8,800,000	457,000	5.2%
Optical	8,161,515	1,720,000	21.1%	9,605,000	2,140,000	22.3%
Shoes	6,464,156	1,637,000	25.3%	6,233,000	869,000	13.9%
Printing	4,890,275	1,910,000	39.1%	5,040,000	1,434,000	28.5%
Precast Concrete	3,861,100	1,714,000	44.4%	2,100,000	438,000	20.9%
Eggs	3,404,007	387,000	11.4%	3,876,000	137,000	3.5%
Bindery	2,814,182	673,000	23.9%	3,515,000	932,000	26.5%
Chicken (Poultry)	2,524,912	-212,000	-8.4%	2,511,000	-237,000	-9.4%
General Fabrication	2,477,213	-1,354,000	-54.7%	5,160,000	-779,000	-15.1%
Mattress	2,406,652	706,000	29.3%	2,768,000	515,000	18.6%
Furniture Assembly & Refinishing	2,400,644	581,000	24.2%	2,506,000	851,000	34.0%
Coffee Roasting	2,358,561	767,000	32.5%	2,140,000	389,000	18.2%
Bakery	2,242,510	516,000	23.0%	1,679,000	197,000	11.7%
Cleaning Products (Detergent)	2,158,255	383,000	17.8%	2,151,000	972,000	45.2%
Knitting Mill	1,885,380	566,000	30.0%	0	0	N/A
Materials Recovery Facility	1,142,207	111,000	9.7%	800,000	-208,000	-26.0%
Crops	796,666	214,000	27.1%	633,000	-443,000	-70.0%
Paper Products	685,099	-57,000	-8.3%	774,000	-109,000	-14.1%
Key Data Entry	676,689	218,000	32.2%	750,000	209,000	27.9%
Micrographics	527,479	-48,000	-9.1%	108,000	-23,000	-21.3%
Metal Signs	315,882	-46,000	-14.6%	362,000	37,000	10.2%
Dental Lab	203,762	-121,000	-59.4%	230,000	-45,000	-19.6%
Silk Screening	180,645	93,000	51.5%	150,000	-6,000	-4.0%
Fiberglass	115,133	-367,000	-318.8%	35,000	-46,000	-131.4%
Vehicle Reconditioning (c)	13,524	-29,000	-214.4%	0	0	N/A
Weaving (Textile) Mill	1,770	-1,457,000	-82,316.0%	0	-236,000	N/A
Total	\$152,240,739	\$30,661,000	20.1%	\$161,972,000	\$31,699,000	19.6%

(a) Gross Profit = Sales (Revenue) - Cost of Sales

(b) Profit Margin = (Gross Profit)/(Sales (Revenue)) X 100%

(c) The vehicle reconditioning factory was shut-down prior to July 1, 1994. Residual sales of \$13,524 related to the closure of the factory.

Appendix D Prison Industry Authority Customer Satisfaction Survey

In order to measure how satisfied customers are with Prison Industry Authority, and to determine what characteristics of the PIA are most important to customers, we developed a questionnaire and mailed it to the PIA's largest customers. The questions asked, and a summary of statistical responses received to each question, are provided in **Exhibit D-1**, at the end of this appendix. A discussion of the results is presented in Chapter 2 of this report.

The 11 largest PIA customers accounted for approximately 88 percent of the \$152 million in sales during fiscal year 1994/95. Nearly all of these customers operate facilities throughout the state, and purchase directly from the PIA. For example, the California Department of Corrections operated 30 institutions during fiscal year 1994/95, and many of these institutions had more than one individual who ordered products directly from the PIA.

To obtain customer input, we mailed the customer satisfaction survey to 120 different buyers at the 11 largest PIA customers. These customers are:

Customer	Number of Buyers	Percent of Sales
<input type="checkbox"/> California Department of Corrections	34	56.5%
<input type="checkbox"/> Department of Motor Vehicles	3	8.6%
<input type="checkbox"/> California State Hospitals	11	7.7%
<input type="checkbox"/> California Youth Authority	11	4.6%
<input type="checkbox"/> California Department of General Services	2	3.4%
<input type="checkbox"/> California Department of Transportation	13	1.9%
<input type="checkbox"/> California Departments of Health Services/Social Services	6	1.6%
<input type="checkbox"/> California State Universities	29	1.1%
<input type="checkbox"/> California Highway Patrol	3	0.7%
<input type="checkbox"/> California Departments of Conservation/Forestry	5	0.7%
<input type="checkbox"/> Employment Development Department	<u>3</u>	<u>0.7%</u>
Total	120	87.5%

Figure D-1, following this page, shows graphically the agencies which use PIA products.

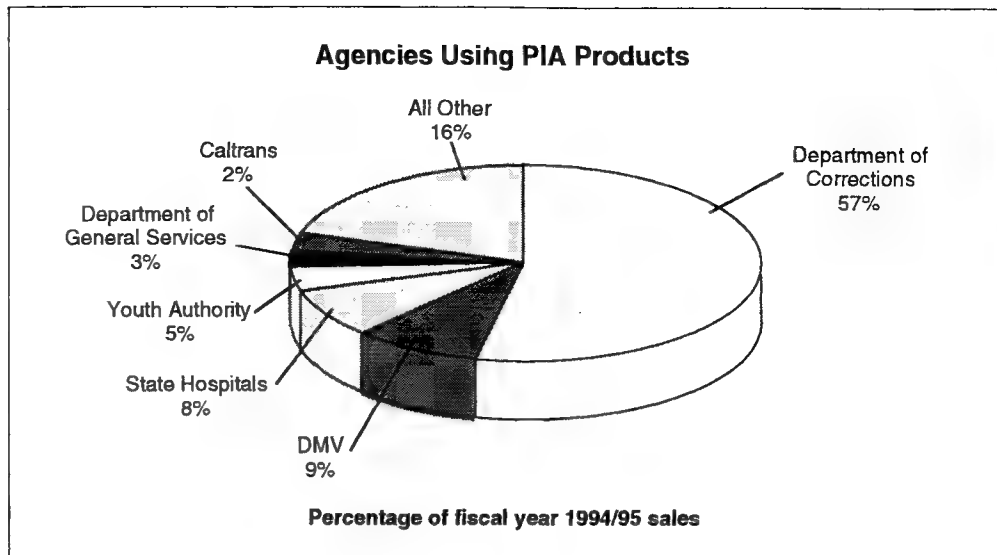


Figure D-1

Of the 120 questionnaires mailed to PIA customers, 74 were returned by the cutoff date. This is a 62 percent response rate.

Each customer was asked to circle the number of the answer which best describes their response to each of the questions listed in Exhibit D-1. The possible answers were as follows.

Satisfaction Rating Scale

1=Extremely dissatisfied	2=Dissatisfied	3=Not quite satisfied
4=Satisfied	5=Extremely satisfied	x=Not applicable

Importance Rating Scale

1=Not at all important	2=Not very important	3=Somewhat important
4=Quite important	5=Extremely important	x=Not applicable

The questionnaire provided space for the customer to comment on specific issues and products for each question.

In addition to requesting customer responses to the mail survey, we also identified 20 products of the PIA, representing a cross section of industries, and asked for additional information about specific purchases regarding prices, delivery times, quality, and competitiveness. It was our intent to obtain more than just anecdotal comments about PIA, and to request information on the most recent actual purchases of discrete products. The form used to collect responses for each product is provided in **Exhibit D-2**, following Exhibit D-1. Results are discussed earlier in the body of this report.

How satisfied are you/How important is it to you that the Prison Industry Authority . . .

1. ...Treats you as an important customer?

	Satisfaction	Importance
1.	5%	0%
2.	14%	3%
3.	22%	16%
4.	50%	34%
5.	9%	47%

7. ...Makes it easy to place an order?

	Satisfaction	Importance
1.	6%	0%
2.	8%	3%
3.	20%	13%
4.	61%	44%
5.	5%	40%

2. ...Keeps you informed so there are no surprises?

	Satisfaction	Importance
1.	12%	0%
2.	15%	1%
3.	41%	12%
4.	28%	34%
5.	4%	53%

8. ...Provides reasonable delivery commitments?

	Satisfaction	Importance
1.	31%	2%
2.	27%	3%
3.	24%	1%
4.	17%	24%
5.	1%	70%

3. ...Is responsive to your needs?

	Satisfaction	Importance
1.	8%	0%
2.	19%	0%
3.	30%	9%
4.	31%	34%
5.	12%	57%

9. ...Makes it easy to expedite orders when necessary?

	Satisfaction	Importance
1.	22%	3%
2.	24%	1%
3.	35%	4%
4.	17%	29%
5.	1%	63%

4. ...Resolves problems that occur?

	Satisfaction	Importance
1.	3%	0%
2.	12%	0%
3.	29%	8%
4.	47%	25%
5.	9%	67%

10. ...Makes it easy to track and get status of orders?

	Satisfaction	Importance
1.	3%	0%
2.	23%	3%
3.	27%	15%
4.	38%	33%
5.	9%	49%

5. ...Provides you a current product catalog?

	Satisfaction	Importance
1.	7%	0%
2.	16%	3%
3.	25%	11%
4.	33%	32%
5.	19%	54%

11. ...Delivers products/services on time?

	Satisfaction	Importance
1.	35%	1%
2.	21%	1%
3.	33%	10%
4.	8%	15%
5.	3%	73%

6. ...Keeps frequently ordered items in stock?

	Satisfaction	Importance
1.	29%	1%
2.	25%	3%
3.	20%	8%
4.	26%	30%
5.	0%	58%

12. ...Delivers high quality products/services?

	Satisfaction	Importance
1.	7%	1%
2.	24%	3%
3.	33%	5%
4.	31%	36%
5.	5%	55%

Satisfaction Rating Scale

1=Extremely dissatisfied
4=Satisfied

2=Dissatisfied
5=Extremely satisfied

3=Not quite satisfied
x=Not applicable

Importance Rating Scale

1=Not at all important
4=Quite important

2=Not very important
5=Extremely important

3=Somewhat important
x=Not applicable

How satisfied are you/How important is it to you that the Prison Industry Authority . . .

13. ...Deliver all items error-free and in correct working order?

	Satisfaction	Importance
1.	4%	1%
2.	18%	3%
3.	36%	4%
4.	37%	36%
5.	5%	56%

14. ...Delivers reasonably priced product services?

	Satisfaction	Importance
1.	23%	1%
2.	20%	1%
3.	25%	7%
4.	29%	31%
5.	3%	60%

15. ...Provides clear product/service invoices?

	Satisfaction	Importance
1.	5%	1%
2.	11%	5%
3.	20%	9%
4.	56%	48%
5.	8%	37%

16. ...Processes waivers in a timely manner?

	Satisfaction	Importance
1.	4%	0%
2.	9%	0%
3.	20%	8%
4.	47%	37%
5.	20%	55%

17. ...Processes product returns and service requests in a timely manner?

	Satisfaction	Importance
1.	14%	0%
2.	14%	2%
3.	28%	18%
4.	38%	45%
5.	6%	35%

18. Please rate your overall satisfaction with the PIA?

	Satisfaction
1.	9%
2.	31%
3.	30%
4.	29%
5.	1%

21. Over the last three years, PIA delivery times have:

40% Improved
55% Remained the same
5% Become worse

19. How do you rate the PIA's overall performance relative to other suppliers?

1% Better than other suppliers
28% Same as other suppliers
71% Worse than other suppliers

22. Over the last three years, PIA product quality has:

23% Improved
70% Remained the same
7% Become worse

20. Over the last three years, the PIA has:

1% Become a lower price alternative
0% Remained a lower price alternative
30% Remained an equal price alternative
61% Remained a higher price alternative
8% Become a higher price alternative

23. Over the last three years, PIA customer service has:

49% Improved
48% Remained the same
3% Become worse

Satisfaction Rating Scale

1=Extremely dissatisfied
4=Satisfied

2=Dissatisfied
5=Extremely satisfied

3=Not quite satisfied
x=Not applicable

Importance Rating Scale

1=Not at all important
4=Quite important

2=Not very important
5=Extremely important

3=Somewhat important
x=Not applicable

Prison Industry Authority Customer Satisfaction Questionnaire

Please answer the following questions specifically as they relate to your purchases of:

Product/Service _____

1

...Approximately how many separate orders for this product did you make during fiscal year 1994/95? _____

2

...Please provide the following information for each of your separate orders (use additional sheets as needed):

Information	Order #1	Order #2	Order #3	Order #4	Order #5	Order #6
Number of Units:						
• Ordered						
• Received						
• Damaged						
• Returned						
Total Cost:						
• Ordered						
• Billed						
Promised Delivery Time (Days)						
Actual Delivery Time (Days)						
Was Product Delivered to Correct Location?						
If Installed by PIA, Was Installation Satisfactory?						
If Available from Commercial Vendor, What Was:						
• Price/Bid Offered?						
• Delivery Time Offered?						
• Vendor's Name and Phone Number?						
Was Quality of PIA Product Above, Same, or Below Expectations?						

3

...As a purchaser of this PIA product, rank in order the attributes which you are most satisfied with (1 least satisfied to 4 most satisfied).

4

...As a purchaser of this PIA product/ service, rank in order of importance to you the following attributes (1 least important to 4 most important).

[] Delivery time [] Quality
[] Price [] Customer service

Agency _____

Contact _____

Phone _____

Appendix E Comparison of Correctional Industries in Other States

To assist with benchmarking the performance of the PIA, we compared its operations with Texas, Florida, New York, and federal government correctional industries. Following California, the three states are the next three largest in number of inmates housed and annual sales of correctional industries.¹

Prior to gathering information from these other industries, we developed two questionnaires: one to obtain general and financial information, and the second to obtain information about the six products selected for review during this performance audit. The first questionnaire was completed by telephone interviews, and the second was completed either by telephone interviews or by the program's management and staff.

A number of exhibits are presented at the end of this appendix which show comparative data we obtained from each state. **Exhibit E-1** presents a comparison of the size, operations, and performance of the PIA with three other states and the federal government. **Exhibit E-2** is a summary of the statement of operations (similar to an income statement) for the five correctional industries, showing revenues, expenses, and net income (loss). **Exhibit E-3** provides a comparison of statutory provisions which relate to training, rehabilitation, and cost reduction goals of each state's program.

The PIA claims cost data are proprietary; therefore, we do not disclose specific product description for the products selected. **Exhibit E-4** compares the sales price and direct costs of four of the six products selected for evaluation during this performance audit: a wood furniture product, a metal product, a food product and a fabric product. The other four correctional programs do not make the metal furniture product selected of the same construction as the PIA, nor provide the service we selected.

We present below summary information for correctional industries in each of the three other states and federal government. We would like to acknowledge the following persons for their assistance in providing information needed to compare programs in each state and the federal government:

- ☐ Texas Correctional Industries – John Bradley, Business Manager

¹ Source: Correctional Industries Association, Inc., 1995 Directory.

-
- ☐ PRIDE of Florida – Pat Foote, Director of Corporate Communications; Mike Smith, Chief of Staff; and Bill Freeman, Vice-President of Operations
 - ☐ New York State Department of Correctional Services Division of Industries (Corcraft) – John Conroy, Director; Joe Tamburr; Assistant Director of Administration; Henry Johnson, Assistant Director of Operations; Jeffrey Smith, Associate Accountant; and Mark Smith, Senior Accountant
 - ☐ Federal Prison Industries (UNICOR) – Emil Carlson, Controller; and Denise Murphy, Executive Assistant to Assistant Director.

Texas

The Industrial Division of the Texas Department of Criminal Justice - Institutional Division (TDCJ-ID) began operations in 1963 with passage of Senate Bill No. 338, authorizing the Department of Criminal Justice to sell prison-made goods to all tax supported agencies and political subdivisions. Today, the Industrial Division is known as the Texas Correctional Industries (TCI).

All products sold by TCI are required to meet specifications developed by and through the State Purchasing Commission. Texas State agencies are required to purchase products from TCI, if its products meet the customer's price, quality, and delivery standards, under a mandatory source preference specified in TCI's enabling statute.

At August 31, 1995, TCI had 37 manufacturing facilities and 6 service facilities. These facilities employed 7,696 inmates at August 31, 1995, or approximately 6.7 percent of the total Texas inmate population.

All employees of TCI are civil service employees. The TCI does not provide incentive pay.

Since 1990, when TDCJ-JD began its extensive expansion program, TDCJ-JD contributed \$49.5 million of new industry buildings and equipment for those buildings. These buildings and equipment represent 53 percent of total TCI fixed assets. Prior to this, the TCI paid for all buildings and nearly all equipment used in operations. The TCI does not make payments on the bonds utilized to fund the contributed buildings and equipment.

The TCI operates from Industrial Revolving Funds and from legislative appropriated funds. The theory since inception of this division is that appropriated money should be able to fund all expenditures to manufacture

items utilized within TDCJ-ID. This includes buildings, equipment, raw materials, supplies, repairs, utilities, and supervisory salaries. The Industrial Revolving Fund then is used to fund expenditures attendant to goods and services of items sold to other tax supported entities.

There is a separate division that warehouses for distribution certain items within TDCJ-ID, such as clothes, shoes, blankets, and office supplies. The TCI operates three warehouses, the costs for which are included in TCI costs. Training costs also are borne by the TCI, although there is not a separate cost line item for this training.

Florida

The Prison Rehabilitative Industries & Diversified Enterprises, Inc., or PRIDE, is a not-for-profit 501(c)(3) business authorized by the Florida Legislature to lease and manage the correctional work programs of the Florida Department of Corrections (DC), independently of state government. PRIDE was incorporated on December 14, 1981 and the transfer of the industries was completed July 1, 1984.

Except for raw agricultural products, PRIDE may sell only to governmental entities or their contract vendors. These entities are not required to purchase PRIDE products. The corporation is required to monitor its business practices to ensure it does not become too competitive with Florida-based private sector businesses.

At June 30, 1996, PRIDE had 41 industry facilities and 12 operational facilities. PRIDE's facilities employed 2,480 inmates at June 30, 1995, or approximately 4.1 percent of the State's inmate population.

PRIDE's employees are not civil service employees. PRIDE executives do receive incentive pay based on financial performance and mission accomplishment.

The transfers of industries completed in 1984 included certain current assets and liabilities of the DC correctional work program and were recorded by PRIDE at estimated fair market value. In addition to these transfers, various lease agreements between PRIDE and DC provide for PRIDE to use certain land, buildings, and equipment in the operation of its industries. PRIDE pays the financing for assets purchased by PRIDE.

PRIDE receives no funding from the Legislature and is totally supported by the revenues it generates from the sale of its products. Business goals, objectives, and measurements drive the company's ability to operate profitably while expanding job training opportunities for prison inmates. Annually, PRIDE

reimburses the State of Florida 1.5 percent of gross sales (an average of over \$1 million per year). PRIDE also donates 15 cents for each \$1 of paid inmate wages to the Victim Restitution Fund (\$264,809 in fiscal year 1994/95).

New York

The New York State Department of Correctional Services (DCS), Division of Industries/Corcraft, was organized in 1894 under the State Constitution of New York. Corcraft's primary mission is to provide for the training and employment of inmates sentenced to state prisons.

Corcraft relationship with the DCS requires each to share facilities and responsibilities regarding the custody of inmates and the management of programs for training and employment. The result of this relationship is that Corcraft receives and provides certain services without recognizing either revenue or cost. The benefits received by each entity are both tangible and intangible and, in the opinion of Corcraft's management, offset each other as nearly as practical.

New York State Law restricts Corcraft's sales to state agencies, local governmental units, the federal government, and other governmental units outside of New York State, and not-for-profit entities within New York State. New York State agencies are required to purchase products from Corcraft, if its products meet the customer's price, quality, and delivery standards, under a mandatory source preference specified in Corcraft's enabling statute.

At March 31, 1995, Corcraft operated 14 manufacturing facilities and 2 service facilities. Corcraft's operations employed approximately 2,600 inmates at March 31, 1995, representing approximately 3.8 percent of the State's total inmate population.

Corcraft's employees are civil service employees. Corcraft does not provide incentive pay to its employees.

The DCS has contributed all Corcraft buildings and 85 percent of Corcraft's equipment. Corcraft pays the financing for only equipment purchased by Corcraft; it does not pay for any of the contributed buildings and equipment.

Corcraft operates with appropriated funds through an internal service fund. Payments are made to the state's general fund for reimbursement of fuel and utilities.

Federal

The Federal Prison Industries, Inc. (FPI) was established in 1934 by an act of Congress. The FPI operates under the trade name UNICOR, as a wholly-owned federal government corporation within the U.S. Department of Justice, and functions under the direction and control of a six member Board of Directors. The FPI's statutory mandate is to provide employment and training for inmates in the federal prison system while remaining self-sufficient through the sales of its products and services.

The FPI's customers consist exclusively of federal government departments and agencies, such as the Department of Defense, General Services Administration and the Department of Veterans Affairs. These and other federal organizations are required to purchase products from FPI, if its products meet the customer's price, quality, and delivery standards, under a mandatory source preference specified in FPI's enabling statute and the Federal Acquisition Regulation.

At September 30, 1994, the FPI had 54 manufacturing facilities and 17 service facilities. The FPI's factories employed 15,972 inmates at September 30, 1994, or approximately 19 percent of the total federal inmate population.

The FPI employees are civil service employees. Beginning with a fiscal year 1996 pilot program, facilities management will receive incentive pay based on financial and productive performance.

The FPI and Federal Bureau of Prisons (BOP) respective missions require each to share facilities and responsibilities relative to the custody, training, and employment of federal inmates. The BOP provides land to FPI for the construction of its manufacturing facilities, and FPI and BOP share certain facilities, generally at no cost.

The BOP builds some FPI buildings. However, all equipment is purchased with FPI funds. The FPI pays the financing (interest costs) for only those assets purchased by FPI.

The FPI operates by means of a revolving fund. No payments are received from, or paid to, the federal government general fund.

Comparison of Correctional Industries in Selected States and Federal Government

	California	Texas	Florida	New York	Federal
Size and Employment					
Inmate Population	120,727	115,524	61,000	69,000	84,000
Incarceration Rate ^(a)	384	636	406	367	387
Inmate Employment	7,012	7,696	2,480	2,600	15,972
Percent Employment	5.8%	6.7%	4.1%	3.8%	19.0%
Inmate Hours Worked (000s)	10,945	7,578	4,600	3,798	N/A
Inmates Paid	Yes	No	Yes	Yes	Yes
Inmate Hourly Pay (\$/hr)	\$0.30-\$0.95	\$0.00	\$0.69	\$0.56	\$0.80
Free Staff Employed	775	510	400	370	1,600
Civil Service	Yes	Yes	No	Yes	Yes
Incentive Pay to Free Staff	No	No	Yes	No	Yes ^(m)
Number of Industries	31	17	20	18	18
Number of Factories	73	37	41	14	54
Sales and Marketing					
Annual Sales (000s)	\$152,241	\$95,942	\$84,733	\$61,203	\$394,901
Annual Sales per Free Staff (000s)	\$226	\$188	\$212	\$165	\$247
Mandatory Sourcing	Yes	Yes	Yes ⁽ⁿ⁾	Yes	Yes
Industries Accounting for 80% of Sales	Fabrics, metal, wood, dairy, license plates, meat processing, optical, shoes, printing, precast concrete	Garments, metal signs, license plates, metal fabrication	General manufacturing, printing, services, agriculture	Garments, furniture, license plates	Furniture, textiles, electronic cable assemblies
Customers Accounting for 80% of Sales	CDC, DMV, St. Hosps., CYA, DGS ^(d)	Department of Corrections, Highway Department	State agencies and local governments	State agencies	Department of Defense, Postal Service, GSA, Department of Veterans Affairs
Percent Sales to Non-State Agencies	2.4%	7.0%	15.0%	10.0%	0.0%
Sales Allowed to In-State Private/Non-Profit	No	Yes-Private ^(e) No-Non-Profit	No	No - Private Yes - Non-Profit	No
Financial					
Gross Profit Margin ^(b)	20.1%	6.8%	17.0%	42.2%	9.1%
General and Administration Costs as Percent of Sales	13.6%	2.5%	13.1%	44.1%	6.5%
Net Profit Margin ^(c)	6.5%	4.3%	3.9%	(1.9%)	2.6%
Days of Inventory on Hand	105	117	47	150	79
Days of Accounts Receivable	44	28	43	54	56
Guard Salaries Included	No	No ^(f)	No ^(f)	Yes	No ^(f)
Utilities Included	Yes	No	Yes	Yes	Yes
Building and Equipment Contributed Depreciation Recognized on Contributed Capital	Yes	Yes (53%)	Yes ⁽ⁱ⁾	Yes ^(k)	Yes (15%)
Interest Paid on Contributed Capital	No	No	No	No	No
Payments to General Fund	No	No	Yes ^(j)	Yes ^(l)	Yes ⁽ⁿ⁾

Footnotes are on the following page.

Comparison of Correctional Industries in Selected States and Federal Government (Continued)

	California	Texas	Florida	New York	Federal
Order Fulfillment					
Department of Corrections Place Annual Orders for Clothing	No	Yes	No	Yes	No
Shipment Schedule for Annual Department of Corrections Order	No	Quarterly	N/A	Quarterly	N/A
Percent On-Time Deliveries Measured	No	No	Yes	No	Yes
Product Management					
Industries Eliminated in Last 5 Years	Swine; Vehicle Reconditioning; Micrographics; Fiberglass	Concrete	Swine	Historical markers	Cotton mill; wool blankets
New Industries Introduced in Last 5 Years	General fabrication; dental lab; crops; material recovery facility	Stainless steel products; plastic injection molding; fire fighting foam; GIS ^(g)	Acquaculture, sports utility vehicles, cattle	Construction; modular homes; asbestos abatement	Recycling laser cartridges; protective clothing for severe climates
New Industries Planned	Dry food packaging (FY 1999)	Material Recycling; truck permitting	Quick Print (FY 96)	Modular cells (FY 96); records conversion; GIS ^(g)	Mattress recycling (FY 96); diesel engine repair (FY 97)

- (a) Incarceration rate is the number of inmates with a sentence of more than one year per 100,000 population. Source: U.S. Department of Justice, Bureau of Justice Statistics, Prisoners in 1994. Bureau of Justice Statistics, Prisoners in 1994.
- (b) Gross profit margin is the difference between total sales and the direct labor, material costs, and applied overhead of those sales.
- (c) Net profit margin is the difference between total sales and total costs.
- (d) CDC: California Department of Corrections
DMV: California Department of Motor Vehicles
St. Hosps: State Hospitals
CYA: California Youth Authority
DGS: California Department of General Services
- (e) Though Texas may legally sell to private industry, it does not do so.
- (f) The Texas, Florida, and federal government correctional industries are responsible for all security of the employed inmates while working at factories.
- (g) GIS – geographical information systems.
- (h) Florida does not exercise its mandatory sourcing, but rather submits bids for competitive procurement.
- (i) Percent of Florida's building and equipment which is contributed is unknown.
- (j) Florida's correctional industry's contribution to the State's General Fund determined by Board of Directors. It has averaged 1.5% of annual gross sales and 0.3% to a Victim Restitution Fund.
- (k) In New York, 100% buildings and 85% equipment are contributed to the program.
- (l) Fuel and utilities are reimbursed.
- (m) The Federal government's pilot program is to provide incentive pay and begins during fiscal year 1996.
- (n) The Federal correctional industries program is required to make payments to general fund if cash available exceeds current operations requirements, as determined by the Government Accounting Office.

Statement of Operations
Correctional Industry Authorities
In Selected States and Federal Government
(\$000s)

	California		Texas		Florida		New York		Federal	
Fiscal Year End	6/30/95		8/31/95		6/30/95		3/31/95		9/30/94	
	Amount	Percent	Amount	Percent	Amount	Percent	Amount	Percent	Amount	Percent
Sales	\$152,241	100.0%	\$95,942	100.0%	\$84,733	100.0%	\$61,203	100.0%	\$394,901	100.0%
Cost of sales	121,699	79.9	89,426	93.2	70,353	83.0	35,382	57.8	358,986	90.9
Gross profit/ margin	\$30,542	20.1	\$6,516	6.8	\$14,380	17.0	\$25,821	42.2	\$35,915	9.1
Operating expenses	20,647	13.6	2,391	2.5	8,875	10.5	20,224	33.0	25,720	6.5
Income before non-operating expenses	\$9,895	6.5	\$4,125	4.3	\$5,505	6.5	\$5,596	9.1	\$10,195	2.6
Vocational training	0	0.0	0	0.0	770	0.9	696	1.1	0	0.0
Security costs	0	0.0	0	0.0	0	0.0	6,064	9.9	0	0.0
Revenue reimbursement to general fund	0	0.0	0	0.0	1,164	1.4	0	0.0	0	0.0
Victim restitution fund donation	0	0.0	0	0.0	265	0.3	0	0.0	0	0.0
Net income (loss)	\$9,895	6.5	\$4,125	4.3	\$3,307	3.9	(\$1,163)	(1.9)	\$10,195	2.6

**Summary of Statutory Purposes
Correctional Industry Authorities
In Selected States and Federal Government**

	California	Florida	New York	Texas	Federal
Training	To acquire or improve occupational skills	To provide inmate training with useful work experience and appropriate job skills to facilitate reentry into society	To employ inmates, so far as practicable, in occupations which will enhance their employability upon release	To provide adequate employment and vocational training and development	To employ and provide skills training to greatest practicable number of inmates in Federal correctional facilities
Rehabilitation	To duplicate, as nearly as possible, private industry working conditions to assure prisoners the opportunity to work productively and acquire or improve effective work habits	To develop attitudes favorable to work and motivate inmates to use their abilities		To provide for rehabilitation of inmates	
Cost reduction and/or containment	To operate a self-supporting work program and reduce the operating cost of the California Department of Corrections	To provide an economic benefit to the public and the department through effective utilization of inmates	To operate on a self-sustained basis	To use inmate labor for self-maintenance	To produce goods in a self-sustaining manner

Correctional Industries Prices and Costs of Four Selected Products

	WOOD FURNITURE PRODUCT			
	California	Texas	New York	Federal
Sales price/unit	\$265.00	\$210.00	\$378.00	\$337.00
Material costs/unit	115.80	179.97	251.58	187.07
Direct labor/unit	0.67	0.00	0.42	1.09
Indirect costs/unit	<u>14.15</u>	<u>3.76</u>	<u>4.50</u>	<u>30.40</u>
Gross profit	\$134.38	\$ 26.27	\$121.50	\$118.44
Overhead calculation basis	Standard hours	Actual hours	Actual production units x standard hours	Standard hours
At what level costs are tracked	Factory	Factory	Product line	Industry

	METAL PRODUCT			
	California	Texas	Florida	New York
Sales price/unit	\$1.60	\$1.10	\$1.32 (Option A); \$2.25 (Option B)	\$2.05
Material costs/unit	0.77	0.77	*	1.51
Direct labor/unit	0.00	0.00	*	0.04
Indirect costs/unit	<u>0.01</u>	<u>0.09</u>	<u>*</u>	<u>0.25</u>
Gross profit	\$0.82	\$0.24	N/A	\$0.25
Overhead calculation basis	Standard hours	Actual hours	Actual machine hours	Actual production units x standard hours
At what level costs are tracked	Factory	Factory	Industry	Discrete product

**Correctional Industries Prices and Costs
of Four Selected Products
(continued)**

	FOOD PRODUCT	
	California	Federal
Sales price/unit	\$0.17	\$0.10
Material costs/unit	NA	*
Direct labor/unit	NA	*
Indirect costs/unit	NA	*
Overhead calculation basis	NA	Production volume
At what level costs are tracked	Factory	Industry

	FABRIC PRODUCT	
	California	New York
Sales price/unit	\$2.90	\$2.83
Material costs/unit	1.44	0.81
Direct labor/unit	0.06	0.13
Indirect costs/unit	<u>0.39</u>	<u>0.61</u>
Gross profit	\$1.01	\$1.28
Overhead calculation basis	Overhead rate x standard hours	Actual production units x standard hours
At what level costs are tracked	Factory	Discrete product

Appendix F Penal Code Sections 2800 – 2880 and 5001 Prison Industry Authority

Chapter 6

SALE OF PRISON-MADE GOODS

Article	Section
1. Prison Industry Authority	2800

Article 1

PRISON INDUSTRY AUTHORITY

Section		Section	
2800.	Establishment; authority.	2806.	Prison industries revolving fund; abolition of correctional industries revolving fund; transfer of funds; major capital outlay projects undertaken by authority; review.
2801.	Purposes.		
2802.	Prison industry board; membership.	2807.	Operation of enterprises; purchase of products by state, county, etc.; report by state agencies and officers.
2803.	Chairman of board; meetings; quorum; majority rule.	2808.	Powers and duties of board.
2804.	Members; per diem; expenses.		
2805.	Jurisdiction; industrial, agricultural and service operations; new enterprises; vocational training programs; equipment, etc.		

Additions or changes indicated by underline; deletions by asterisks * * *

PENAL CODE

§ 2801

Section		Section	
2809.	Civilian staff; personnel practices and procedures; appointments.	2813.5.	Restored and rebuilt vehicles.
2810.	Borrowing funds.	2814.	Agricultural products; sale to private persons.
2810.5.	Loans from pooled money resources board.	2815.	Sale of articles in foreign countries.
2811.	Compensation for prisoner employees; schedule; one-half of minimum wage; credit to prisoner accounts.	2816.	Transfer to or deposits in prison industries revolving fund; public works projects performed by inmate labor.
2812.	Sale of articles made by convict or prison labor; misdemeanor.	2817.	Inmate construction revolving account; creation.
2813.	Handiwork articles; sale to public; materials; credit to prisoners' accounts.	2818.	New industries revolving account in prison industries revolving fund.
		2870 to 2877.	Repealed.

Article 1 was added by Stats.1982, c. 1549, p. 6039, § 28.

Former Article 1 was repealed by Stats.1982, c. 1549, p. 6044, § 29.

Cross References

Jail industry commissions in counties of ninth or nineteenth class, see Penal Code § 4325 et seq.

§ 2800. Establishment; authority

There is hereby established the Prison Industry Authority. As used in this article "authority" means the Prison Industry Authority.

(Added by Stats.1982, c. 1549, p. 6039, § 28.)

Historical and Statutory Notes

1982 Legislation.

Sections 2 and 3 of Stats.1982, c. 1549, p. 6034, provide:

"Sec. 2. The Legislature finds and declares that:

"(a) The present prison industries program has failed to provide productive jobs to prisoners, to meaningfully offset the cost of running the prison system, or to reduce the idleness and underemployment which are rampant in California's prisons.

"(b) The constraints of state government severely impede the ability of the prison industries program to operate on a self-supporting or profit-making basis.

"(c) A successful prison industries program can best be accomplished by providing the management of the prison industries program with a reasonable degree of autonomy and by establishing a special authority to manage and operate prison industries and the funds associated with such programs.

"Sec. 3. It is the intent of the Legislature that:

"(a) The operation of the prison industries program be self-sustaining, financed from its own operating resources.

"(b) The prison industries program reduces the burdensome cost of the correctional system on the citizens of this state through the establishment of self-sustaining or profit-making enterprises which are operated primarily by inmates and which do not unfairly compete with private enterprise.

"(c) The prison industries program promote the security goals of the Department of Corrections by reducing idleness and providing an incentive for work in prisons, thereby contributing to an atmosphere in which tension and violence will be reduced.

"(d) The prison industries program serve the goal of reintegrating ex-offenders into the outside working population by replicating as closely as possible free world production and service operations, in conjunction with relevant education, training, and post-release job placement."

Derivation: Former § 5085 added by Stats.1947, c. 1137, p. 2579, § 3.

§ 2801. Purposes

The purposes of the authority are:

(a) To develop and operate industrial, agricultural, and service enterprises employing prisoners in institutions under the jurisdiction of the Department of Corrections, which enterprises may be located either within those institutions or elsewhere, all as may be determined by the authority.

(b) To create and maintain working conditions within the enterprises as much like those which prevail in private industry as possible, to assure prisoners employed therein the opportunity to work productively, to earn funds, and to acquire or improve effective work habits and occupational skills.

(c) To operate a work program for prisoners which will ultimately be self-supporting by generating sufficient funds from the sale of products and services to pay all the expenses of the program, and one which will provide goods and services which are or will be used by the Department of Corrections, thereby reducing the cost of its operation.

(Added by Stats.1982, c. 1549, p. 6039, § 28.)

Additions or changes indicated by underline; deletions by asterisks * * *

Historical and Statutory Notes

Derivation: Former § 5091 added by Stats.1947, c. § 1; Stats.1953, c. 419, p. 1669, § 1; Stats.1955, c. 659, p. 1137, p. 2580, § 3, amended by Stats.1949, c. 1379, p. 2399, 1153, § 1; Stats.1963, c. 979, p. 2240, § 1.

Library References

Convicts ⇐10(1).
C.J.S. Convicts § 16.

§ 2802. Prison industry board; membership

The authority shall be under the policy direction of a board of directors, to be known as the Prison Industry Board, and to be referred to hereafter as the board. The board shall consist of eleven members:

- (a) The Director of Corrections shall be a member.
- (b) The Director of the Department of General Services, or his or her designee, shall be a member.
- (c) The * * * Secretary of the Trade and Commerce Agency, or his or her designee, shall be a member.
- (d) The Speaker of the Assembly shall appoint two members to represent the general public.
- (e) The Senate Rules Committee shall appoint two members to represent the general public.
- (f) The Governor shall appoint four members. Of these, two shall be representatives of organized labor, and two shall be representatives of industry. The initial term of one of the members appointed by the Speaker of the Assembly shall be two years, and the initial term of the other shall be three years. The initial term of one of the members appointed by the Senate Rules Committee shall be two years, and the initial term of the other shall be three years. The initial terms of the four members appointed by the Governor shall be four years. All subsequent terms of all members shall be for four years. Each member's term shall continue until the appointment and qualification of his successor.

(Added by Stats.1982, c. 1549, p. 6039, § 28. Amended by Stats.1984, c. 449, § 40, eff. July 17, 1984; Stats.1993, c. 1153 (A.B.1732), § 196, eff. Oct. 11, 1993.)

Historical and Statutory Notes

1984 Amendment. Added "or her" following "his" in two places; and substituted, in subd. (c), "Director of Commerce" for "Director of Department of Economic and Business Development".

Derivation: Former § 5085, added by Stats.1947, c. 1137, p. 2579, § 3.

Former § 5086, added by Stats.1947, c. 1137, p. 2579, § 3.

1993 Legislation

The 1993 amendment, in subd. (c), substituted "Secretary of the Trade and Commerce Agency" for "Director of Commerce".

Library References

Convicts ⇐10(1).
C.J.S. Convicts § 16.

§ 2803. Chairman of board; meetings; quorum; majority rule

The Director of Corrections shall be the chairman of the board. The chairman shall be the administrative head of the board and shall exercise all duties and functions necessary to insure that the responsibilities of the board are successfully discharged. The board shall meet regularly at least four times during each fiscal year, and shall hold extra meetings on the call of the chairman or a majority of the board. Six members of the board, including the chairman, shall constitute a quorum. The vote of a majority of the members in office is necessary for the transaction of the business of the board.

(Added by Stats.1982, c. 1549, p. 6040, § 28. Amended by Stats.1983, c. 958, § 1.5, eff. Sept. 20, 1983.)

Historical and Statutory Notes

1983 Amendment. Inserted the second sentence.

Derivation: Former § 5087, added by Stats.1947, c. 1137, p. 2579, § 3.

Additions or changes indicated by underline; deletions by asterisks * * *

§ 2804. Members; per diem; expenses

The appointed members of the board shall receive a per diem to be determined by the chairman, but not less than the usual per diem rate allowed to the Department of Corrections employees during travel out of state. All members, including the chairman, shall also receive their actual and necessary expenses of travel incurred in attending meetings of the commission and in making investigations, either as a board or individually as members of the board at the request of the chairman. All the expenses shall be paid from the Prison Industries Revolving Fund.

(Added by Stats.1982, c. 1549, p. 6040, § 28.)

Historical and Statutory Notes

Derivation: Former § 5088, added by Stats.1947, c. 1137, p. 2579, § 3, amended by Stats.1963, c. 1350, p. 2878, § 1.

§ 2805. Jurisdiction; industrial, agricultural and service operations; new enterprises; vocational training programs; equipment, etc.

The authority shall assume jurisdiction over the operation of all industrial, agricultural, and service operations formerly under the jurisdiction of the Correctional Industries Commission. In addition, the authority shall have the power to establish new industrial, agricultural and service enterprises which it deems appropriate, to initiate and develop new vocational training programs, and to assume jurisdiction over existing vocational training programs. The authority shall have control over and the power to buy and sell all equipment, supplies and materials used in the operations over which it assumes control and jurisdiction.

(Added by Stats.1982, c. 1549, p. 6040, § 28.)

Historical and Statutory Notes

Derivation: Former § 5090, added by Stats.1947, c. 1137, p. 2580, § 3.

§ 2806. Prison industries revolving fund; abolition of correctional industries revolving fund; transfer of funds; major capital outlay projects undertaken by authority; review

There is hereby constituted a permanent revolving fund in the sum of not less than seven hundred thirty thousand dollars (\$730,000), to be known as the Prison Industries Revolving Fund, and to be used to meet the expenses necessary in the purchasing of materials and equipment, salaries, construction and cost of administration of the prison industries program. The fund may also be used to refund deposits either erroneously made or made in cases where delivery of products cannot be consummated. The fund shall at all times contain the amount of at least seven hundred thirty thousand dollars (\$730,000), either in cash or in receivables, consisting of raw materials, finished or unfinished products, inventory at cost, equipment, or any combination of the above. Money received from the rendering of services or the sale of products in the prisons and institutions under the jurisdiction of the board shall be paid to the State Treasurer monthly and shall be credited to the fund. At any time that the authority and the Director of Finance jointly determine that the balance in said revolving fund is greater than is necessary to carry out the purposes of the authority, they shall so inform the Controller and request a transfer of the unneeded balance from the revolving fund to the General Fund of the State of California. The Controller is authorized to transfer balances upon request. Funds deposited in the revolving fund are not subject to annual appropriation by the Legislature and may be used without a time limit by the authority.

The Prison Industries Revolving Fund is not subject to the provisions of Articles 2 (commencing with Section 13320) and 3 (commencing with Section 13335) of Chapter 3 of Part 3 of Division 3 of Title 2 of the Government Code.

The revolving fund created by Section 2714 known as the Correctional Industries Revolving Fund is abolished, and the Controller shall transfer the balance in that revolving fund to the Prison Industries Revolving Fund. Any major capital outlay project undertaken by the authority shall be subject to review by the Public Works Board pursuant to the provisions of Part 10.5 (commencing with Section 15752) of Division 3 of Title 2 of the Government Code.

(Added by Stats.1982, c. 1549, p. 6040, § 28. Amended by Stats.1983, c. 956, § 2, eff. Sept. 20, 1983.)

Additions or changes indicated by underline; deletions by asterisks * * *

Historical and Statutory Notes

1983 Amendment. Added the second paragraph and in the third paragraph inserted the second sentence.

Former § 5094, added by Stats.1947, c. 1137, p. 2581, § 3.

Derivation: Former § 2714, added by Stats.1945, c. 84, p. 393, § 1, amended by Stats.1953, c. 1298, p. 2853, § 1.

Library References

Convicts ~~§~~10(1).
C.J.S. Convicts § 16.

§ 2807. Operation of enterprises; purchase of products by state, county, etc.; report by state agencies and officers

(a) The authority is hereby authorized and empowered to operate industrial, agricultural, and service enterprises which will provide products and services needed by the state, or any political subdivision thereof, or by the federal government, or any department, agency, or corporation thereof, or for any other public use. Products may be purchased by state agencies to be offered for sale to inmates of the department and to any other person under the care of the state who resides in state-operated institutional facilities. Fresh meat may be purchased by food service operations in state-owned facilities and sold for onsite consumption.

(b) All things authorized to be produced under subdivision (a) shall be purchased by the state, or any agency thereof, and may be purchased by any county, city, district, or political subdivision, or any agency thereof, or by any state agency to offer for sale to persons residing in state-operated institutions, at the prices fixed by the board. State agencies shall make maximum utilization of these products, and shall consult with the staff of the authority to develop new products and adapt existing products to meet their needs.

(c) The following state agencies and officers shall report by January 1 of each year to the Director of General Services and to the Chairperson of the Joint Legislative Budget Committee on their use in the prior fiscal year of goods and services provided by the authority, and shall include comments on planned future use of these goods and services:

- (1) The State and Consumer Services Agency.
- (2) The Business, Transportation and Housing Agency.
- (3) The Health and Welfare Agency.
- (4) The Resources Agency.
- (5) The Youth and Adult Correctional Agency.
- (6) The California Environmental Protection Agency.
- (7) The Department of Food and Agriculture.
- (8) The Attorney General.
- (9) The Secretary of State.
- (10) The Treasurer.
- (11) The Controller.
- (12) The Superintendent of Public Instruction.

Reports submitted under this subdivision shall be specific as to department and unit under each agency's or office's jurisdiction.

(Added by Stats.1982, c. 1549, p. 6041, § 28. Amended by Stats.1988, c. 458, § 1; Stats.1989, c. 369, § 1; Gov.Reorg.Plan No. 1 of 1991, § 153, eff. July 17, 1991; Stats.1992, c. 467 (A.B.2564), § 1.)

Historical and Statutory Notes

1988 Legislation

The 1988 amendment added the second sentence of subd. (a); and, in subd. (b), inserted "or by any state agency to offer for sale to persons residing in state-operated institutions".

1989 Legislation

The 1989 amendment added subd. (c) relating to submission of reports by state agencies and officers, and made nonsubstantive changes throughout.

1991 Legislation

Gov.Reorg.Plan No. 1 of 1991, in the list of state agencies and officers in subd. (c), substituted "The Califor-

Additions or changes indicated by underline; deletions by asterisks * * *

nia Environmental Protection Agency" for "The Environmental Affairs Agency".

Effective date of Governor's Reorganization Plan No. 1 of 1991, dated May 17, 1991, see Gov.C. § 12080.5.

1992 Legislation

The 1992 amendment in subd. (a) added "Fresh meat may be purchased by food service operations in state-

owned facilities and sold for onsite consumption.", and in subd. (c)(6) substituted "California Environmental Protection Agency" for "Environmental Affairs Agency".

Derivation: Former § 5091, added by Stats.1947, c. 1137, p. 2580, § 3, amended by Stats.1949, c. 1379, p. 2399, § 1; Stats.1953, c. 419, p. 1669, § 1; Stats.1955, c. 659, p. 1153, § 1; Stats.1963, c. 979, p. 2240, § 1.

Library References

Convicts ~~6~~7(1).

C.J.S. Convicts § 13.

§ 2808. Powers and duties of board

The board shall, in the exercise of its duties, have all the powers and do all the things which the board of directors of a private corporation would do, except as specifically limited in this article, including, but not limited to, the following:

(a) To enter into contracts and leases, execute leases, pledge the equipment, inventory and supplies under the control of the authority and the anticipated future receipts of any enterprise under the jurisdiction of the authority as collateral for loans, and execute other necessary instruments and documents.

(b) To assure that all funds received by the authority are kept in commercial accounts according to standard accounting practices.

(c) To arrange for an independent annual audit.

(d) To review and approve the annual budget for the authority, in order to assure that the solvency of the Prison Industries Revolving Fund is maintained.

(e) To contract to employ a general manager to serve as the chief administrative officer of the authority. The person so appointed shall serve at the pleasure of the chairman. The general manager shall have wide and successful experience with a productive enterprise and have a demonstrated appreciation of the problems associated with prison management.

* * *

(f) To apply for and administer grants and contracts of all kinds.

(g) To establish, notwithstanding any other provision of law, procedures governing the purchase of raw materials, component parts, and any other goods and services which may be needed by the authority or in the operation of any enterprise under its jurisdiction. Such procedures shall contain provisions for appeal to the board from any action taken in connection with them.

(h) To establish, expand, diminish, or discontinue industrial, agricultural and service enterprises under its jurisdiction to enable the authority to operate as a self-supporting organization, to provide as much employment for inmates as is feasible, and to provide diversified work activities to minimize the impact on existing private industry in the state.

(i) To hold public hearings pursuant to paragraph (h) above to provide an opportunity for persons or organizations who may be affected to appear and present testimony concerning the plans and activities of the authority. The authority shall assure adequate public notice of such hearings. No new industrial, agricultural, or service enterprise which involves a gross annual production of more than fifty thousand dollars (\$50,000) shall be established unless and until a hearing concerning the enterprise has been held by a committee of persons designated by the board including at least two board members. The board shall take into consideration the effect of a proposed enterprise on California industry and shall not approve the establishment of the enterprise if the board determines it would have a comprehensive and substantial adverse impact on California industry which cannot be mitigated.

(j) To periodically determine the prices at which activities, supplies, and services shall be sold.

(k) To report to the Legislature in writing, on or before February 1 of each year, regarding:

(1) The financial activity and condition of each enterprise under its jurisdiction.

(2) The plans of the board regarding any significant changes in existing operations.

(3) The plans of the board regarding the development of new enterprises.

Additions or changes indicated by underline; deletions by asterisks * * *

(4) A breakdown, by institution, of the number of prisoners at each institution, working in enterprises under the jurisdiction of the authority, said number to indicate the number of prisoners which are not working full time.

(Added by Stats.1982, c. 1549, p. 6041, § 28. Amended by Stats.1983, c. 180, § 1; Stats.1983, c. 803, § 36.6; Stats.1983, c. 1150, § 1.8; Stats.1985, c. 1413, p.—, § 1, eff. Oct. 1, 1985.)

Historical and Statutory Notes

1983 Amendments. Substituted in the first sentence of the first paragraph of subd. (e) "contract to employ an executive director" for "appoint a general manager"; added the second paragraph of subd. (e); rewrote the third and fourth sentences of subd. (i) which had read:

"No new industrial, agricultural, or service enterprise which involves a gross annual production of more than fifty thousand dollars (\$50,000) shall be established unless and until a hearing concerning the enterprise has been held by the authority. The authority shall take into consideration the effect of a proposed enterprise on California industry and shall not approve the establishment of the enterprise if it would have a comprehensive and substantial adverse impact on a particular California business, enterprise, or industry."; and at the end of subd. (j), deleted, "which prices, except for articles or services to be sold to the Department of Corrections, shall be as near as possible to the prices for which agencies eligible to pur-

chase would buy items of equivalent quality from commercial sources."

Amendment of this section by §§ 1, 1.5, 1.7 of Stats. 1983, c. 1150, failed to become operative under the provisions of § 5 of that Act.

1985 Amendment. Substituted references to general manager for references to executive director in the first and third sentences of subd. (e); and deleted the former second paragraph of subd. (e), which had read:

"Any provision in the annual Budget Act providing for the compensation of a general manager shall be deemed to be available for the purpose of paying the executive director."

Derivation: Former § 2871, added by Stats.1941, c. 106, p. 1102, § 15, amended by Stats.1957, c. 2256, p. 3932, § 44.

Former § 5092, added by Stats.1947, c. 1137, p. 2581, § 3.

Library References

Convicts ⇌10(3).
C.J.S. Convicts § 16.

§ 2809. Civilian staff; personnel practices and procedures; appointments

Notwithstanding any other provision of law, the authority may recruit and employ such civilian staff as may be necessary to carry out the purposes of this article, and shall establish recruiting, testing, hiring, promotion, disciplinary, and dismissal procedures and practices which will meet the unique personnel needs of the authority. The practices may include incentives based on productivity, profit-sharing plans, or other criteria which will encourage civilian employee involvement in the productivity goals of the authority. The procedures and practices shall apply to all employees working in enterprises under the jurisdiction of the authority. The Director of Corrections shall be the appointing authority for all personnel of the authority other than the general manager.

(Added by Stats.1982, c. 1549, p. 6043, § 28.)

§ 2810. Borrowing funds

The board may authorize the borrowing of money by the authority for purposes of:

(a) Operating the business affairs of the authority.

(b) Purchasing new equipment, materials and supplies.

(c) Constructing new facilities, or repairing, remodeling, or demolishing old facilities. Funds may be borrowed from * * * private sources, upon such terms as the board deems appropriate, including but not limited to, the use of equipment under the jurisdiction of the authority, and of the future income of an enterprise under the jurisdiction of the authority, as collateral to secure any loan.

(Added by Stats.1982, c. 1549, p. 6043, § 28. Amended by Stats.1985, c. 966, § 1, eff. Sept. 26, 1985.)

Historical and Statutory Notes

1985 Amendment. Substituted "borrowing of money by the authority" for "borrowing of money be the authority" in the introductory clause; and substituted "Funds may be borrowed from private sources" for "Funds may be borrowed from the State Treasury to be repaid over up to 20 years, upon interest rates fixed by the Director of Finance, comparable to the lowest class of risk of state investment. In addition, funds may be borrowed from

private sources" in the second sentence of subd. (c) (formerly the second and third sentences) of subd. (c).

Section 4 of Stats.1985, c. 966, § 4 provides:

"This act shall not become operative unless both this bill and A.B. 727 of the 1985-86 Regular Session [Stats. 1985, c. 1413] of the Legislature are enacted, in which case this bill shall become operative on the effective date of the bill that is enacted last."

Additions or changes indicated by underline; deletions by asterisks * * *

Library References

Convicts ⇐10(3).
C.J.S. Convicts § 16.

§ 2810.5. Loans from pooled money resources board

Notwithstanding any other provision of law, the Pooled Money Investment Board may grant loans to the authority when money is appropriated for that purpose by the Legislature, upon application by the Prison Industry Board, in order to finance the establishment of a new industrial, agricultural, or service enterprise. All loans shall bear the same interest rate as the pooled money market investment rate and shall have a maximum repayment period of 20 years from the date of approval of the loan.

Prior to making its decision to grant a loan, the Pooled Money Investment Board shall require the authority to demonstrate all of the following:

(a) The proposed industry project cannot be feasibly financed from private sources under Section 2810. The authority shall present proposed loan conditions from at least two private sources.

(b) The proposed industry project cannot feasibly be financed from proceeds from other Prison Industry Authority enterprises.

(c) The proceeds from the proposed project provide for a reasonable payback schedule to the General Fund.

(Added by Stats.1983, c. 1150, § 2. Amended by Stats.1985, c. 966, § 2, eff. Sept. 26, 1985.)

Historical and Statutory Notes

1985 Amendment. Added the second paragraph with its lettered subdivisions.

§ 2811. Compensation for prisoner employees; schedule; one-half of minimum wage; credit to prisoner accounts

The board shall adopt and maintain a compensation schedule for prisoner employees. Such compensation schedule shall be based on quantity and quality of work performed and shall be required for its performance, but in no event shall such compensation exceed one-half the minimum wage provided in Section 1182 of the Labor Code, except as otherwise provided in this code. This compensation shall be credited to the account of the prisoner.

Such compensation shall be paid from the Prison Industries Revolving Fund.

(Added by Stats.1982, c. 1549, p. 6043, § 28.)

Library References

Convicts ⇐10(3).
C.J.S. Convicts § 16.

§ 2812. Sale of articles made by convict or prison labor; misdemeanor

It is unlawful for any person to sell, expose for sale, or offer for sale within this state, any article or articles manufactured wholly or in part by convict or other prison labor, except articles the sale of which is specifically sanctioned by law.

Every person selling, exposing for sale, or offering for sale any article manufactured in this state wholly or in part by convict or other prison labor, the sale of which is not specifically sanctioned by law, is guilty of a misdemeanor.

(Added by Stats.1982, c. 1549, p. 6043, § 28.)

Historical and Statutory Notes

Derivation: Former § 2876 added by Stats.1941, c. 893, p. 2470, § 2.

§ 2813. Handiwork articles; sale to public; materials; credit to prisoners' accounts

The director may provide for the manufacture of small articles of handiwork by the prisoners out of raw materials purchased by the prisoners with their own funds or funds borrowed from the Inmates'

Additions or changes indicated by underline; deletions by asterisks * * *

Welfare Fund, or from raw materials furnished by the director without compensation therefor as provided in this section which articles may be sold to the public at the state prisons, in public buildings, at fairs, or on property operated by nonprofit associations. State-owned property shall not be given to prisoners for use under this section, unless all proceeds from the sale thereof shall be deposited in the Inmates' Welfare Fund. The director may provide that all or a part of the sale price of all other articles manufactured and sold under this section be deposited to the account of the prisoner manufacturing the article.

(Added by Stats.1982, c. 1549, p. 6044, § 28.)

Historical and Statutory Notes

Derivation: Former § 2877, added by Stats.1941, c. § 46; Stats.1959, c. 1394, p. 3673, § 1; Stats.1968, c. 1101, 510, p. 1821, § 1, amended by Stats.1957, c. 2256, p. 3932, p. 2114, § 1; Stats.1969, c. 909, p. 1814, § 1.

Library References

Convicts ☞10(3).
C.J.S. Convicts § 16.

§ 2813.5. Restored and rebuilt vehicles

Notwithstanding any other provision of this chapter except subdivision (i) of Section 2808, and notwithstanding subdivision (l) of Section 22851.3 of the Vehicle Code, the Director of Corrections may provide for the inmates in trade and industrial education or vocational training classes established under Section 2054 to restore and rebuild donated salvageable and abandoned vehicles. * * * If these vehicles comply with Section 24007.5 of the Vehicle Code, they may be sold at public auction to private persons. This activity * * * shall be subject to the public hearing * * * requirements of subdivision (i) of Section 2808 * * * at any time that this activity involves a gross annual production of more than fifty thousand dollars (\$50,000).

The proceeds of the sale after deduction of the cost of materials shall be deposited * * * in the * * * Restitution Fund in the State Treasury and, upon appropriation by the Legislature, may be used for indemnification of victims of crimes * * *.

(Added by Stats.1989, c. 923, § 1. Amended by Stats.1991, c. 1157 (A.B.2157), § 1.)

Historical and Statutory Notes

1991 Legislation

The 1991 amendment rewrote the section which formerly read:

"Notwithstanding any other provision of this chapter except subdivision (i) of Section 2808, the Director of Corrections may provide for the inmates in trade and industrial education or vocational training classes established under Section 2054 to restore and rebuild donated salvageable vehicles. Provided that these vehicles comply with Section 24007.5 of the Vehicle Code, they may be sold at public auction to private persons. No activity authorized by this section shall be established until the hearing,

consideration, and approval requirements of subdivision (i) of Section 2808 have been completed with regard to that activity.

"The proceeds of the sale after deduction of the cost of materials shall be deposited into a special account in the Special Deposit Fund by the Director of Corrections. Money in that account may, upon appropriation, be allocated by the director to a nonprofit agency to be used for the assistance of crime victims, or to the Restitution Fund in the State Treasury for indemnification of victims of crimes, but may not be used for any other purpose."

§ 2814. Agricultural products; sale to private persons

Notwithstanding any provision of this chapter, products and byproducts of agricultural and animal husbandry enterprises, except nursery stock, may be sold to private persons, at public or private sale, under rules prescribed by the board.

(Added by Stats.1983, c. 1150, § 3.)

§ 2815. Sale of articles in foreign countries

The authority may, under rules prescribed by the board, dispose of products developed from the operations of industrial enterprises in prisons and institutions under the jurisdiction of the authority by sale to foreign governments, corporations for distribution in foreign countries, and private persons or their agents in markets outside the United States and in countries which permit the importation of prison-made goods. All sales made pursuant to this section shall be reported to the Legislature in the board's annual report pursuant to Section 2808.

(Added by Stats.1983, c. 1150, § 4.)

Additions or changes indicated by underline; deletions by asterisks * * *

§ 2816. Transfer to or deposits in prison industries revolving fund; public works projects performed by inmate labor

With the approval of the Department of Finance, there shall be transferred to, or deposited in, the Prison Industries Revolving Fund for purposes authorized by this section, money appropriated from any source including sources other than state appropriations.

Notwithstanding subdivision (i) of Section 2808, the chairman, in consultation with the board, may order any authorized public works project involving construction, renovation, or repair of prison facilities to be performed by inmate labor when the total expenditure does not exceed two hundred thousand dollars (\$200,000). Projects entailing expenditure of greater than two hundred thousand dollars (\$200,000) shall be reviewed and approved by the board.

Money so transferred or deposited shall be available for expenditure by the department for the purposes for which appropriated, contributed or made available, without regard to fiscal years and irrespective of the provisions of Sections 13340 and 16304 of the Government Code. Money transferred or deposited pursuant to this section shall be used only for purposes authorized in this section. (Added by Stats.1983, c. 958, § 2, eff. Sept. 20, 1983.)

§ 2817. Inmate construction revolving account; creation

The Inmate Construction Revolving Account is hereby created in the Prison Industries Revolving Fund, established in Section 2806, to receive funds transferred or deposited for the purposes described in Section 2816.

(Added by Stats.1983, c. 958, § 2.5, eff. Sept. 20, 1983.)

§ 2818. New industries revolving account in prison industries revolving fund

The New Industries Revolving Account is hereby created in the Prison Industries Revolving Fund to receive General Fund or other public money transferred or deposited for the purpose of financing new enterprises or the expansion of existing enterprises. Money in the fund may be disbursed by the board subject to the conditions prescribed in Section 2810.5.

(Added by Stats.1985, c. 966, § 3, eff. Sept. 26, 1985.)

§§ 2870 to 2877. Repealed by Stats.1982, c. 1549, p. 6044, § 29**Historical and Statutory Notes**

See, now, § 2800 et seq.

Article 2**SALE OF PRISON GOODS MADE OUTSIDE CALIFORNIA****Section**

2880. Applicability of California law.

Section

2884. Disinfection or sterilization of goods; certificate.

§ 2880. Applicability of California law

To the extent and insofar as the same may be permitted under the provisions of the Constitution of the United States and the acts of Congress, * * * all goods, wares, and merchandise manufactured, produced, or mined wholly or in part by prisoners (except prisoners on parole or probation) or manufactured, produced, or mined wholly or in part in any state prison, transported into the State of California and remaining herein for use, consumption, sale, or storage, shall upon arrival and delivery in this state be subject to the operation and effect of the laws of this state to the same extent and in the same manner as though those commodities had been manufactured, produced, or mined in this state by prisoners or in any state prison, and shall not be exempt therefrom by reason of being introduced in the original package or otherwise.

(Amended by Stats.1987, c. 828, § 125.)

Additions or changes indicated by underline; deletions by asterisks * * *

§ 5001. Composition

The department is composed of the Director of Corrections and the * * * Prison Industry Authority.
(Amended by Stats.1985, c. 1413, § 2.)

Historical and Statutory Notes

1985 Amendment. Substituted "and the Prison Industry Authority" for "the Board of Prison Terms and the Correctional Industries Commission".

Appendix G

**Response to the Auditor's Report
from the Prison Industry Authority**

PRISON INDUSTRY BOARD

1515 "S" Street, Room 119-S • P.O. Box 942883
Sacramento, California 94283-0001
(916) 445-2818 • FAX (916) 323-0281

April 3, 1996

James H. Gomez, Chair
John C. Lungren, Jr., Vice Chair

MEMBERS

William E. Allen
Robert E. Burton
Rotea J. Gilford
Patricia A. Jones
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Darshan H. Singh
Willard S. Voit
Thomas V.A. Wornham

EXECUTIVE OFFICER
Joella M. Fazio

Kurt R. Sjoberg, State Auditor
Bureau of State Audits
660 J Street, Suite 300
Sacramento, California 95814

Dear Mr. Sjoberg:

BUREAU OF STATE AUDITS DRAFT AUDIT REPORT

Thank you for the opportunity to review and comment on the BSA draft report of findings regarding Prison Industry Authority's (PIA) performance. I fully recognize that auditing an organization as diverse and complex as PIA is no easy task. However, it is my perception that this report deviates from the consistent application of audit principles in three critical areas:

The audit fails to establish consistent criteria against which to audit PIA performance.

①*

The audit succumbs to the very inconsistency it believes flaws PIA statutory purpose: Is PIA a program or a business? Having determined at the outset that PIA is a state program, the audit virtually dismisses its own findings regarding PIA's performance compared to other major state industry programs - where it excels - in order to bench mark PIA performance against private industry - which it is not. The consequence of this inconsistency is that the audit's recommended statutory changes do not follow from its findings. Ultimately they neither provide PIA with additional flexibility to operate in a businesslike fashion, nor resolve the dilemma of PIA's current statutory inconsistencies.

The audit deviates from not only Generally Accepted Accounting Principles (GAAP), but also nationwide standards for industry programs.

②

Self-sufficiency is a fairly straightforward accounting principle, and PIA measures and reports it consistent not only with GAAP, but with other state industry reporting. While an audit might take exception to such a standard, it generally does not have the prerogative to abandon accepted standards in favor of its own unique interpretation (as this audit has admittedly done)

* Our comments on the response from the Prison Industry Authority begin on page H-1.

and then develop findings based on this interpretation. An example of the consequence of this approach is the recommendation that PIA account for, display, and recover from its customers, costs it did not incur.

The goals against which PIA achievement was measured were derived from the audit's standards, not established from the expectations that prevailed during the past 12 years of PIA's performance.

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Clearly, the Legislature has the prerogative to alter the rules under which PIA operates and to hold it accountable for future performance based on those rules, but in this instance it is the audit which has changed the rules: For example, the issue of self-sufficiency centers on bond funds authorized by the Legislature which did not choose to require interest as a PIA expense. The audit has measured PIA performance based not on the Legislature's expectation, nor on GAAP, nor on other State programs, but rather on the audit's own philosophy. If it had been the Legislature's expectation that PIA should be managed to include contributed capital, the Legislature would have let the people responsible for that management know about such expectations during the performance period. Consequently, this audit holds PIA accountable for goals that are not yet set.

In addition to these issues of fundamental audit consistency, I take exception to the audit findings related to the Prison Industry Board (PIB). The audit levels sweeping criticism at PIB, based on no objective standard that I can discern: The audit team did not interview the Chairman of the Board or any interested labor or business parties on these issues, nor did they request of PIA any board or committee meeting minutes, records of public hearings, or even find time to attend the PIB meeting held during the tenure of the audit. This reflects a cavalier attitude towards establishing an objective basis from which to make such criticisms. Board members are primarily private citizens who invest significant personal time and have made positive contributions to PIA through public service. They deserve better.

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Of final concern is that while PIA is a critical tool in successfully managing our prison population, this is acknowledged nowhere in the audit findings. California prisons are at 186 percent of design capacity, the assault rate on staff has increased 50 percent in the past five years, the rate of inmate on inmate assaults is up 25 percent, and inmate unemployment in institutions averages 19 percent. The job waiting list for CDC inmates is larger than the total correctional population in 32 other states.

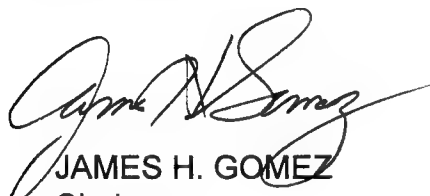
Mr. Kurt R. Sjoberg
Page 3

I bring this to your attention because I believe that audit findings such as ...*“unable to empirically demonstrate its success in meeting its stated program purposes, with the exception that it does employ some inmates”...* and *“...we do not doubt that happily employed inmates are easier to handle and control”...* reflect a fundamental failure of the audit team to grasp the true nature of the environment in which PIA operates, and what it brings to that environment. That PIA provides productive employment for over 7,000 inmates, and does so better than any other state, is a major benefit to California taxpayers, not only in the millions of dollars saved in costs to house inmates, but in the reduction of inmate unrest and violence in our prisons. PIA also represents a goal for inmates to reach, which we believe significantly enhances institutional behavior for all inmates. The Department understands this fact, the Legislature believes and provides funding to support it, a report cited in the audit even validates this - but the audit findings essentially dismiss it.

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Again, my thanks to you and your audit staff for all their effort. I hope you will seriously consider these concerns in the development of final findings.

Sincerely,



JAMES H. GOMEZ
Chairman

cc: Prison Industry Board Members
PIB Executive Officer

PRISON INDUSTRY AUTHORITY RESPONSE TO THE BUREAU OF STATE AUDITS REPORT

OVERVIEW

Prison Industry Authority (PIA) is concerned that in its report of findings, the Bureau of State Audits (BSA) established a new set of priorities and principles for PIA, and then measured the organization against this new set of standards rather than those under which PIA has operated for the past 12 years. Not only does this minimize what PIA has accomplished, it tells little about its ability to achieve what the State and the Legislature have asked of it.

The audit correctly identifies that PIA is a penal program that exists to employ inmates - and PIA has accomplished that more successfully than any other state prison industry program. At 7,209 inmates employed, it is second only to Texas in the number of inmates it employs. Contrary to the audit implication that employment is declining, in the past ten years **PIA has achieved a 117.6 percent increase in its inmate employment**, almost 40 percent ahead of the growth rate for any other major state or the federal industry program during this period. (See Figure 1)

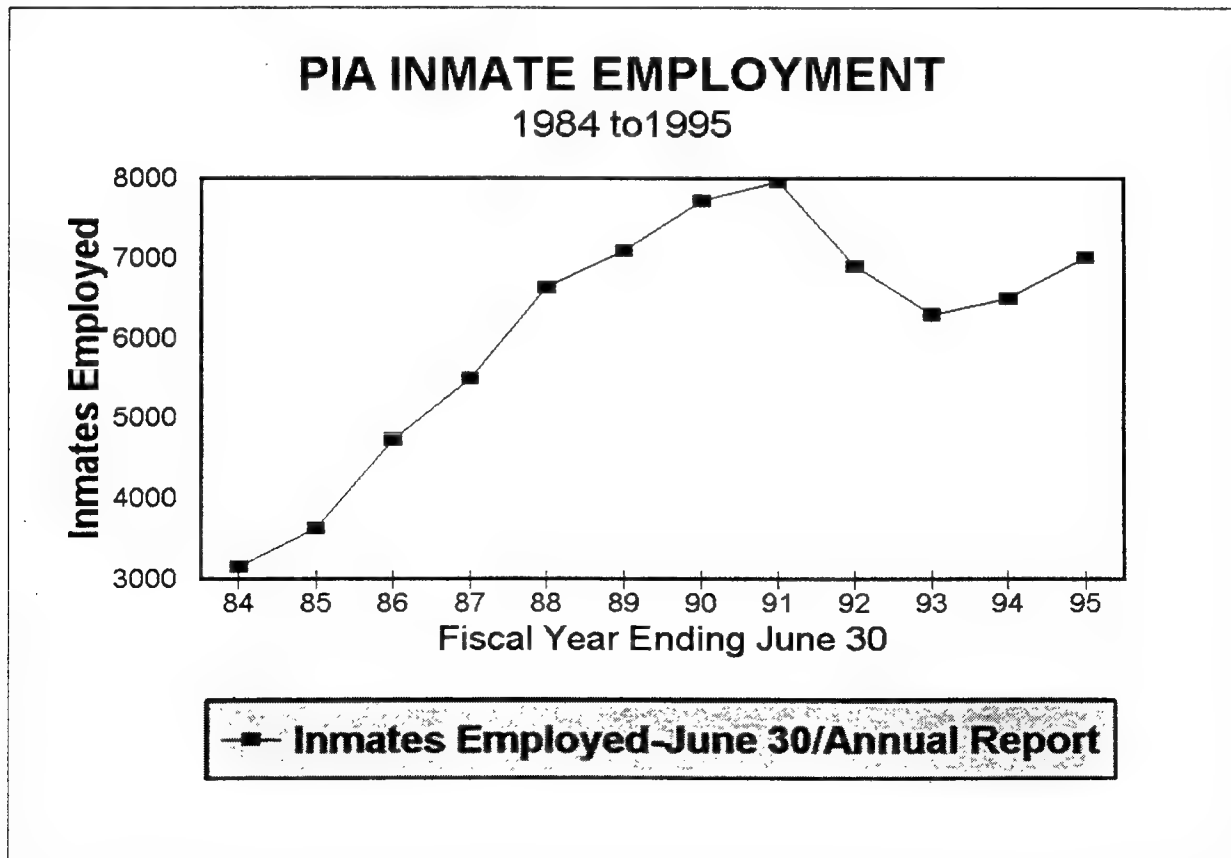


Figure 1

The audit finds this employment an unremarkable benefit to the State because neither PIA nor the California Department of Corrections (CDC) have quantified how this improves effective work habits or job skills, nor measured the impact on what BSA has defined as PIA's "*core objective*" of reducing recidivism. The Legislature established PIA's core objective as providing productive jobs to prisoners. This was clear in the legislative intent for establishing PIA, it is clear in PIA's governing statutes, it has been a constant of its operating mission, and has been the focus of PIA resources.

This is not to imply that work ethic, skills, and recidivism are not desirable objectives. The audit is correct in finding that quantifiable data is critical to assessing such program impact, and PIA will be working with CDC to develop the necessary data systems. However, in the realities of a prison system approaching 200 percent of design bed capacity with an inmate job waiting list in excess of 15,000, the fact that PIA has taken over 7,000 inmates off the weight piles and out of the yard and put them to work in factories, is a tremendous benefit to maintaining control and reducing violence in our prisons. 7

The audit further asserts that there is no offset to the \$109 million the State has invested in the work space for PIA's use, even as it **acknowledges that PIA's inmate employment over the past ten years has saved the State over \$187 million in costs to program and house inmates**. This is considered not a truly quantifiable benefit because it is not "*unique*" to PIA. This is akin to saying one's salary does not represent real money because others had a similar opportunity to earn it, which seems a questionable audit standard. 8

The audit standard for determining self-sufficiency is equally questionable. Based on independently audited annual financial statements prepared in accordance with Generally Accepted Accounting Principles (GAAP), PIA is self-supporting. It has achieved 1.7 percent retained earnings (or net profit) on total revenues over the duration of its operations. The State's investment in PIA is appropriately recorded as contributed capital. 9

The audit finds that PIA is not self-supporting because it does not report interest costs for this capital, even though: 10

- ▶ the Legislature did not intend or require PIA to pay the interest on this bond funding;
- ▶ other correctional industry programs do not pay interest on contributed capital and equipment;
- ▶ PIA is unaware of any other program funded by general obligation bonds which report such interest on their financial statements; and
- ▶ such reporting would not be consistent with GAAP.

Clearly the audit has the prerogative to disagree with the Legislature on this issue. That it does so is not an acceptable basis for attributing ten years of such accumulated interest to PIA's cost and then finding PIA has failed to achieve self-sufficiency because it did not recover an expense that it does not, in reality, incur.

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If the intent is to view PIA's cost/benefit from the perspective of the taxpayer, then this broader perspective must include not only General Fund costs for bond interest, but also the offsetting General Fund savings in reduced costs to house and program inmates that was discussed earlier. Based on PIA's current inmate employment, these savings now accrue at the rate of more than \$19 million annually. The net impact of these offsets for the taxpayer over the past ten years of PIA operation is displayed in Figure 2. While this could be almost endlessly refined to include rent subsidies to PIA offset by unfunded work PIA performs for CDC, none will significantly close the approximately \$133 million gap between PIA's accumulated \$54 million interest cost to the taxpayer and its \$187 million benefit.

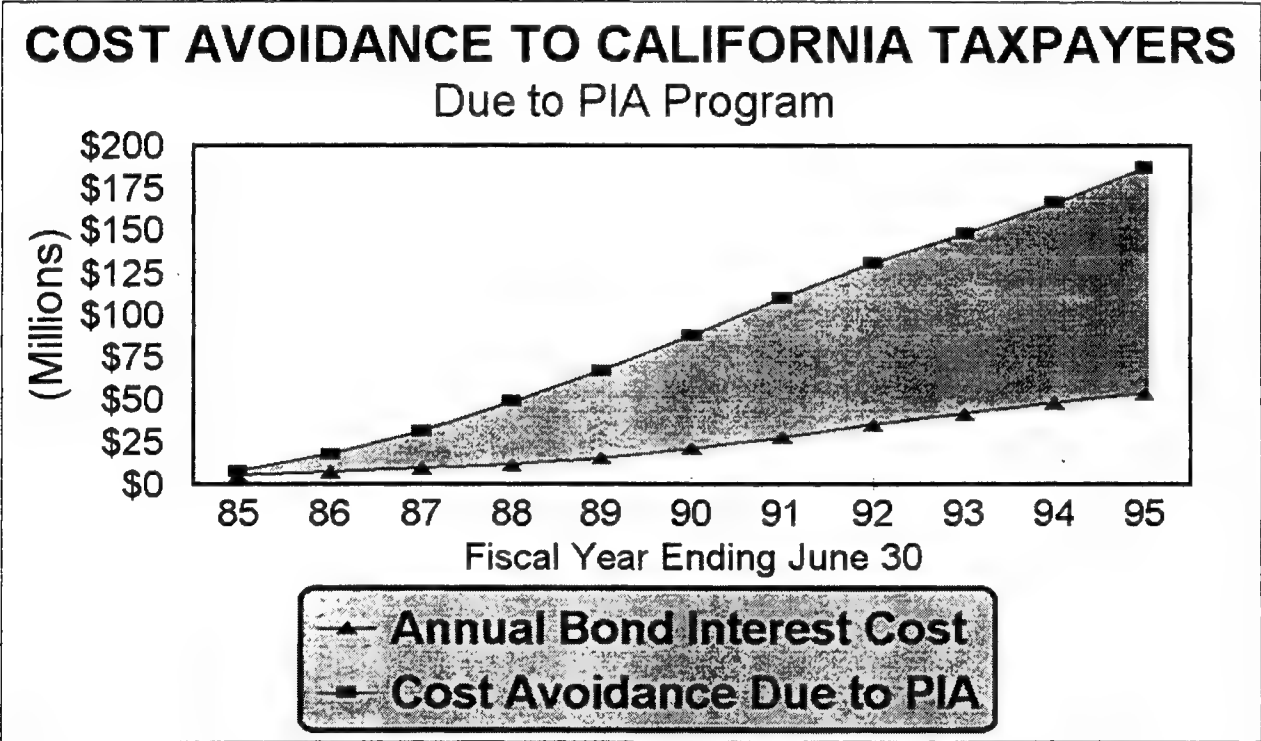


Figure 2 Shaded area represents the **Net Cost Avoidance to the Taxpayer**

PIA was pleased to note the audit finding was that *"on average, PIA prices are near the mid-point when compared to the range of prices of other suppliers that sell similar products"*. PIA is committed to achieving an even more competitive market position on its pricing through implementation of the current competitive pricing strategy noted in the audit.

However, the finding that PIA is an average of 7.8 percent higher than lowest comparative prices is misleading. PIA prices include delivery; discussion with audit staff indicate comparable product prices used in the audit did not, and this adds significantly to final product costs.

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PIA further agrees with the overall need to continue improving management process and controls. However, in bench marking PIA performance on multiple indicators, the audit abandoned its primary principle that PIA was a State program and focused on performance compared to private industry. Despite finding that PIA compared favorably to other major government industry programs surveyed (Texas, Florida, New York, and the Federal UNICOR), on every measure of operational performance, the body of audit findings related to PIA performance is clearly focused on private industry standards.

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While such standards are laudable, little is accomplished by holding PIA management to a standard it has no authority or flexibility to attain. This measures not how well PIA has achieved its statutory expectations so much as how constrained it is as a State program.

Moreover, the audit does not provide any statutory relief from such constraints, but instead recommends the Legislature consider making PIA a division of CDC. Ironically, this is the same approach the Legislature consciously abandoned in 1982, finding that the constraints of State government impeded the ability of the industry program to provide productive work for inmates.

Chapter 1

INMATE EMPLOYMENT HAS DECLINED WHILE THE NUMBER OF STATE FREE STAFF HAS INCREASED

17

The audit's focus on presenting PIA inmate employment as a declining percentage of CDC's surging prison population masks the very real and substantial growth PIA has accomplished. PIA's statutory purpose is to employ inmates, and it has achieved this purpose more successfully than any other state prison industry program. In the past decade, PIA has achieved a phenomenal 117 percent increase in its inmate employment, far surpassing not only comparably sized state programs, including Texas (49 percent), Florida (80 percent) and New York (12 percent), but even federally operated UNICOR (74 percent) as reflected in Figure 3.

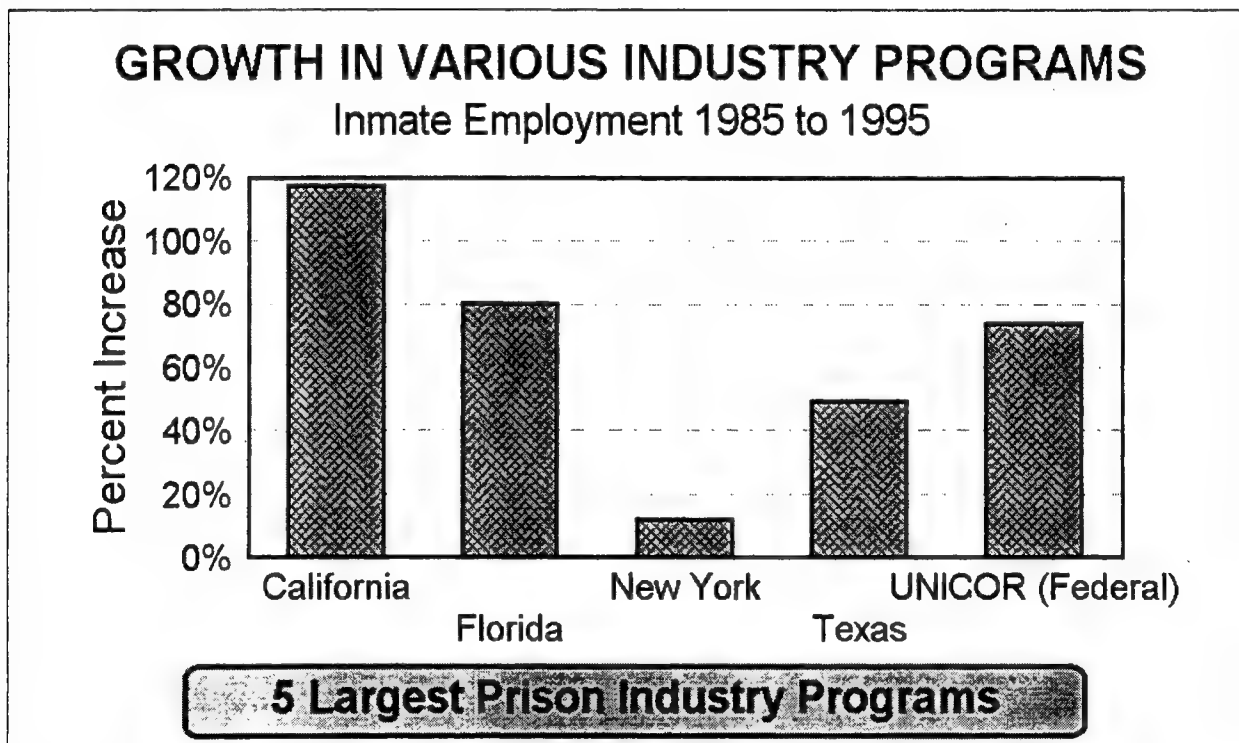


Figure 3

Contrary to the audit assertion that inmate employment has declined while free staff increased, as Figure 4 indicates, what PIA experienced in the period cited by the audit was a temporary decline in inmate employment (with a concomitant decrease in budgeted staff positions) as PIA adjusted to the tightening economic realities of the early 1990's. This slight decline is bracketed by consistent growth trends, and PIA is currently experiencing its third consecutive year of growth.

Even PIA's inmate employment as a percent of total CDC population, compares favorably to other major correctional systems. Among the eight reporting states which housed more

than 30,000 inmates at the close of 1995, PIA is tied at second with Texas, behind only Pennsylvania, in the percent of inmates employed. With an inmate population of 31,245, Pennsylvania's standing suggests that small and even declining employment percentages more likely reflect the size and rate of growth of the total inmate population than the performance of the industry program.

The base upon which BSA computes the percentage growth in free staff is

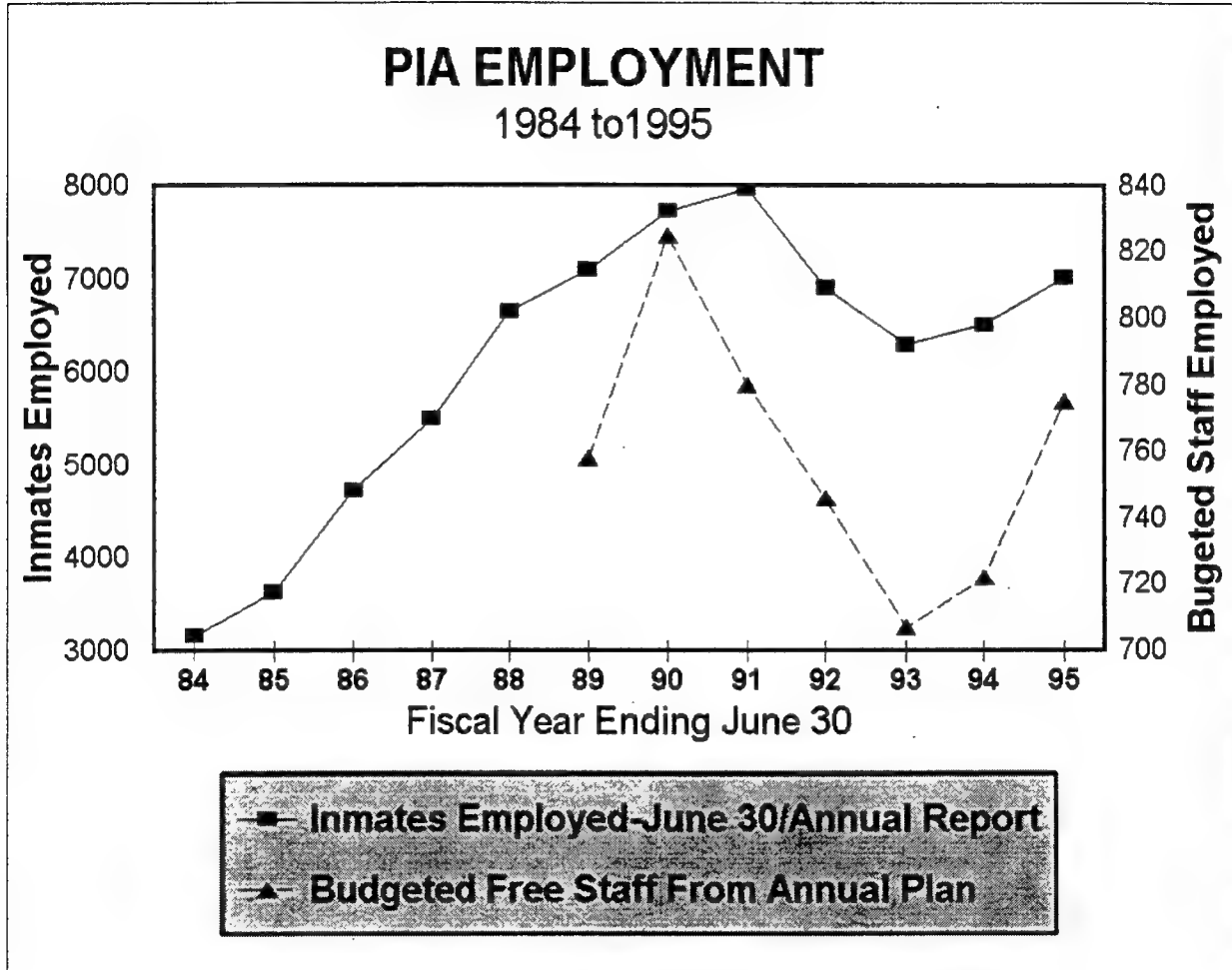


Figure 4

erroneous. In Chapter 1 of the report, the auditors discuss the growth in civil service Personnel Years (PY's) from Fiscal Year (FY) 1989-90 through FY 1994-95. The number of staff used in the audit report for FY 1989-90 was lifted from a consultant report prepared in early 1990. It represents neither budgeted nor prior year actual data and cannot be substantiated.

The BSA chose to use this data because information on FY 1989-90 prior year actuals is unavailable. In the absence of this information, there are several approaches to demonstrate the relative change in PIA civil service positions over the five-year period. One can use:

- ▶ Prior year actual PY's for all years **except** FY 1989-90. For that year, use other data (BSA approach).
- ▶ Budgetary figures for FY 1989-90 through FY 1994-95
- ▶ Prior year actual PY's, beginning with FY 1990-91
- ▶ The June 30 point-in-time "count" of employees as reflected in PIA's Annual Reports.

Figure 5 graphically depicts these approaches.

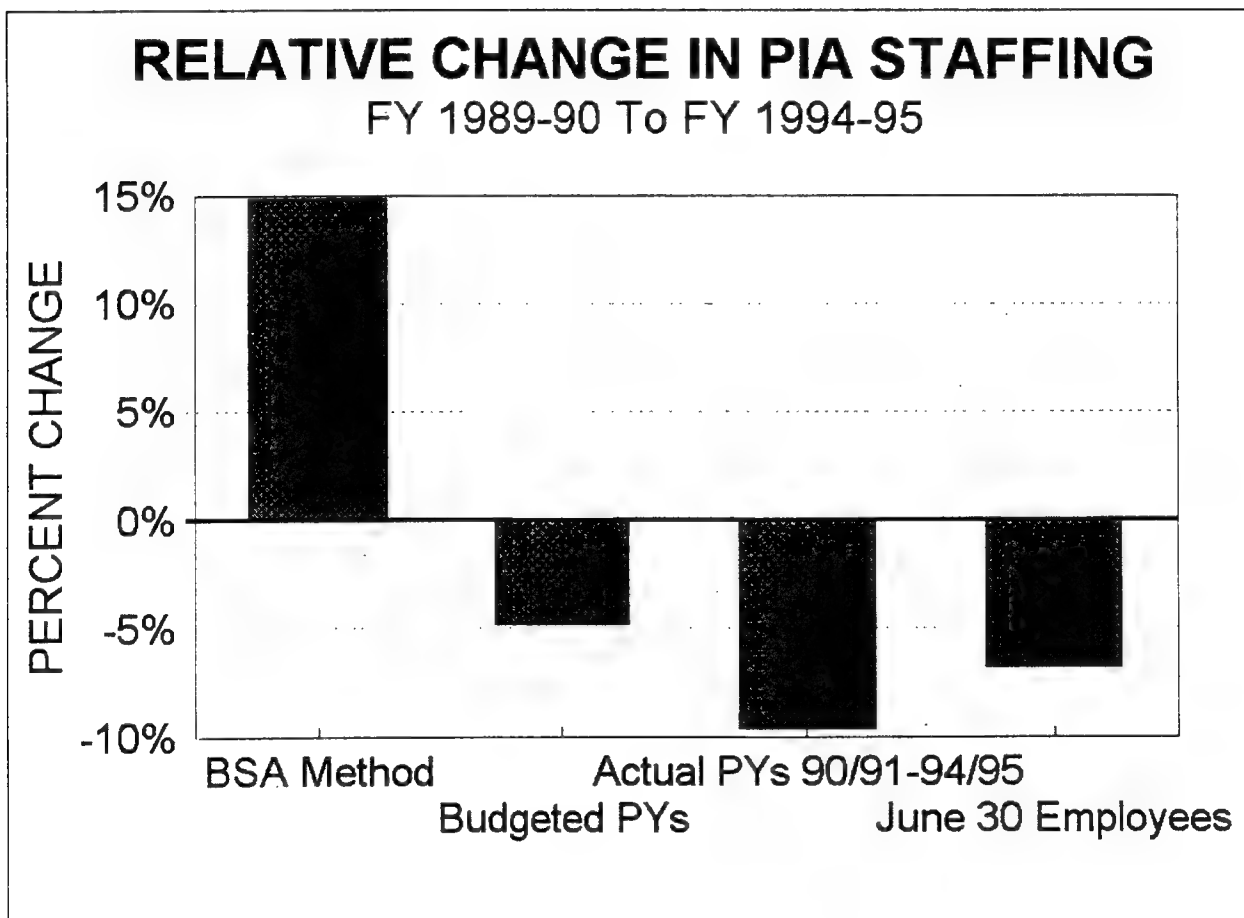


Figure 5

As one can see, the unsubstantiated data used in the audit truly distorts PIA's staffing picture. **PIA has reduced civil service staff from FY 1990-91 to FY 1994-95 by almost 10 percent.** As the audit correctly noted, PIA sales during this period increased by one-third.

PIA IS NOT SELF-SUPPORTING AND HAS NOT PAID ALL EXPENSES OF THE PROGRAM

PIA fundamentally disagrees with the State Auditor's finding that PIA is not self-supporting and that it has not reported all expenses of the program. Specifically, the State Auditor asserts that PIA has been heavily "subsidized" throughout its 12-year history through interest-free capital contributions as well as below cost rent for the facilities which it uses. The State Auditor then concludes that because the financial statements of PIA do not reflect these subsidies, the financial performance and profitability reported by PIA are distorted.

Unfortunately, the State Auditor's finding is based upon a "philosophical" construct which is diametrically opposed to the operating environment in which PIA actually exists. In effect, **the State Auditor has created hypothetical criteria by which to measure PIA**, an approach which is not fitting. PIA believes that the State Auditor's finding should be scrutinized in light of three critical criteria: 1) legislative intention; 2) practices of comparable correctional industry programs; and, 3) GAAP.

1. The State Auditor points out that PIA has not paid \$54 million in interest on \$109 million of capital contributed by the General Fund, thereby receiving an interest subsidy. In fact, the Legislature never intended PIA to incur interest expense on contributed capital (i.e., bond proceeds from general obligation and revenue bonds). **If the Legislature had intended PIA to pay interest, it would have directed PIA to do so in statute.** Indeed, examples abound of State programs---General Fund and non-General Fund---that receive bond proceeds, but do not incur the debt service expense. Additionally, PIA is unaware of any programs funded by general obligation bonds which also report the interest on their respective financial statements.
2. In referring to the practices of correctional industries in Texas, Florida, New York, and the Federal Government, the audit report explicitly states on Page III-29:

"All correctional industries utilize buildings and equipment which were contributed to it by an external fund. However, none of the programs pay interest or bond costs related to this contributed capital." (underline added)

Thus, the State Auditor fully recognizes that it is not a commonly accepted practice for correctional industries to pay interest on contributed capital. Similarly, in a detailed review of comparable correctional industries (Appendix E), the State Auditor presents no evidence that any program is paying full value rent of facilities used, but not owned. To the contrary, it appears that each program has a favorable lease/rental agreement. In the

case of the Federal Government, the *"Federal Bureau of Prisons and the Federal Prison Industries share certain facilities, generally at no cost."* (Page E-5)

3. Additionally, the State Auditor observes that although PIA's financial statements are prepared in accordance with GAAP, they do not address situations where a government entity receives non-cash subsidies from another segment of government. The State Auditor's "model" for ascribing rent and interest subsidies to PIA is based on that of the private sector, even though the report separately acknowledges that it is "unfair to compare PIA's profitability and rate of return with the private sector". (Page I-8). (underline added)

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With respect to financial reporting, GAAP as promulgated by the Governmental Accounting Standards Board and the American Institute of Certified Public Accountants, is the sole "accepted" authority for financial reporting. PIA's financial statements are audited annually in accordance with GAAP by a certified public accountant as required by law. Accordingly, PIA affirms that its audited financial statements fairly represent PIA's current financial condition, results of operations, and cash flows. If the Legislature changes the operating requirements under which PIA operates, PIA will reflect such changes in its financial statements in accordance with GAAP as well.

In short, PIA is troubled by the overall framework of this finding. The State Auditor is evaluating PIA on rules which are not justified by any measure of legislative intent, practices of comparable programs throughout the country, or GAAP. Surely, had PIA been directed to pay the interest expense associated with the proceeds of bond issues, PIA would have modified its operations and corresponding price structure to incorporate the effects of the additional costs. However, there was no such requirement nor is there any comparable model on which to base such a requirement.

Notwithstanding our objection to the above audit premise, the manner in which the State Auditor supports this issue appears to be faulty as well. The audit attributes a \$33 million loss to PIA for the 12 year period ended June 30, 1995. This is computed by subtracting \$54 million in interest "subsidies" from PIA's accumulated retained earnings of \$21 million. PIA's concern is that while the interest payments are expressed in FY 1994-95 dollars using the Consumer Price Index, the annual increments of net income are presented in historical dollars (i.e., according to the audited financial statements). Thus, the auditor is subtracting apples from oranges. This methodology only serves to further cloud the audit's concept of subsidies.

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PIA CUSTOMERS PAY HIGH PRICES TO SUBSIDIZE INMATE WORK PROGRAMS

This finding does not validate that PIA customers pay “high” prices. It discusses, at length, that PIA charges above cost for some products to offset selling other products below cost in order to maximize production and inmate labor. PIA agrees, and in fact believes it would be remiss if it did not. Capitalizing on competitive strengths to support lesser efficiencies is a standard business practice - which in this instance, carries the bonus of employing inmates.

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PIA agrees customers would be paying high prices to subsidize inmate work if the price of products from PIA was substantially and consistently higher than purchasing from the private sector - which it is not (see audit discussion next section). If PIA continues its current practice and still keeps its prices within competitive market range, there is no impact on the taxpayer.

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If the recommended rigid “at cost” pricing structure drives PIA out of the competitive market on some products or lines, the resulting loss of inmate employment will drive up CDC costs, which in turn either reduces General Fund monies for other agencies or increases taxpayers costs. This seems like a major administrative effort (and cost) with minimal fiscal benefit to the State. PIA is statutorily required to be self-sufficient as a whole. This has never been interpreted by the Legislature as applying on a product by product or on an enterprise basis.

OVER ONE-HALF OF PIA’S PRODUCTS WOULD NOT BE COMPETITIVE IN STANDARD STATE PROCUREMENTS

Actually, the stated audit finding is that *“on average, PIA prices are near the mid-point when compared to the range of prices of other suppliers that sell similar products”*. Further, while PIA was above lowest quoted price on 13 products, it was **below lowest quote on nine products** - a fairly reasonable spread.

PIA is firmly committed to achieving a more competitive stance on its product pricing, as demonstrated by its implementation of the competitive pricing strategy noted in the audit. However, the finding that PIA is an average of 7.8 percent higher than lowest comparative prices is misleading. PIA prices include delivery; discussion with audit staff indicate quotes used in the audit did not. State procurement requires not only lowest bid, but that all bids include freight costs. Freight can add as much as 33 percent to the cost of some products. The service cited in the audit would require daily deliveries to multiple sites within a prison. To private business, time is money, and the time required for security clearances can more than double the cost of delivery.

14

THE PIA DOES NOT APPEAR TO REDUCE THE COSTS OF OPERATING A PRISON

While the State Auditor concludes that PIA does not appear to reduce the costs of operating a prison, the report goes on to state in the narrative, *"Although the table shows that total costs per inmate for prisons with PIA is greater than those without, there are many other significant factors which influence these costs. Therefore, we cannot conclude that these costs are either greater or lower at institutions with PIA."* (Underline added).

The table being referenced, Table I-5, displays the auditors' calculation of security, education, and vocational costs per inmate for FY 1994-95 at prisons with PIA and prisons without PIA. PIA was informed by the auditors that there was "noise in the data"; having reviewed the supportive data, PIA agrees. Among the inconsistencies noted, the base data:

- ▶ Erroneously claims it is based on actual FY 1994-95 cost and inmate population numbers.
- ▶ Includes 100 percent of the maximum security prisons in the state in the PIA cost per inmate analysis without acknowledging their higher security costs, thus skewing the data.
- ▶ Erroneously counts inmates housed in reception centers with the "Non-PIA facilities" thereby incorrectly reducing cost per inmate for programming;
- ▶ **Excludes** costs in the Department of Forestry's budget for specific firefighting training provided to inmates, but **includes** these inmates in the population count.
- ▶ Excludes over 4,000 inmates and over \$25 million in associated security costs while claiming to have included all such factors.
- ▶ Incorrectly considers only salary costs. It does not consider any other costs associated with prison operations.

PIA agrees with the auditors that based on this type of analysis, no overall conclusion regarding PIA's contributions can be drawn, and none should be. However, a very quantifiable and significant contribution to CDC can be identified by examining the impact of sentence reduction credits on CDC operations.

COSTS AVOIDED THROUGH THE PIA ARE NOT UNIQUE

The total cost avoidance provided by PIA to CDC from FY's 1984-85 through 1994-95 is \$187 million, yet the audit report makes two very troubling statements. First, it states that *"other programs provide the same benefit"*. Inmates earn sentence reduction credits through participation in many CDC programs. The combined impact of all of these

is over \$500 million annually in reduced housing costs for CDC. That PIA is not the sole source of this cost avoidance is irrelevant.

Secondly, the audit states, *"However, there is little empirical evidence to verify or disprove the sentence reduction benefits of the PIA program, especially from the taxpayers perspective."* This defies all logic. PIA's inmate employment over the past ten years has saved the State over \$169 million in costs to house inmates. Cost avoidance through sentence reduction credits has been and continues to be recognized by various sectors of State government evaluating prison operating costs. As far back as FY 1986-87, **the Legislative Analyst Office recommended that CDC increase inmate programming to achieve greater sentence reduction credits, which would reduce long-term operating costs.** If the audit wishes to question the benefits of sentence reduction credits earned through PIA's programs, then it needs to consider this impact on the millions of dollars in annual savings that accrue to CDC through its other program efforts.

In addition to the \$169 million in reduced cost to house inmates, another \$18 million in cumulative cost avoidance to CDC is accrued for the inmates PIA employed at the Southern Maximum Security Complex (SMSC), Tehachapi. The State Auditor agrees that legislation did mandate inmate programming and that each inmate employed by PIA at SMSC is one less inmate that would have to be included in a vocational education program, per statute. Figure 6 graphically displays the cost avoidance achieved by PIA over the last ten years.

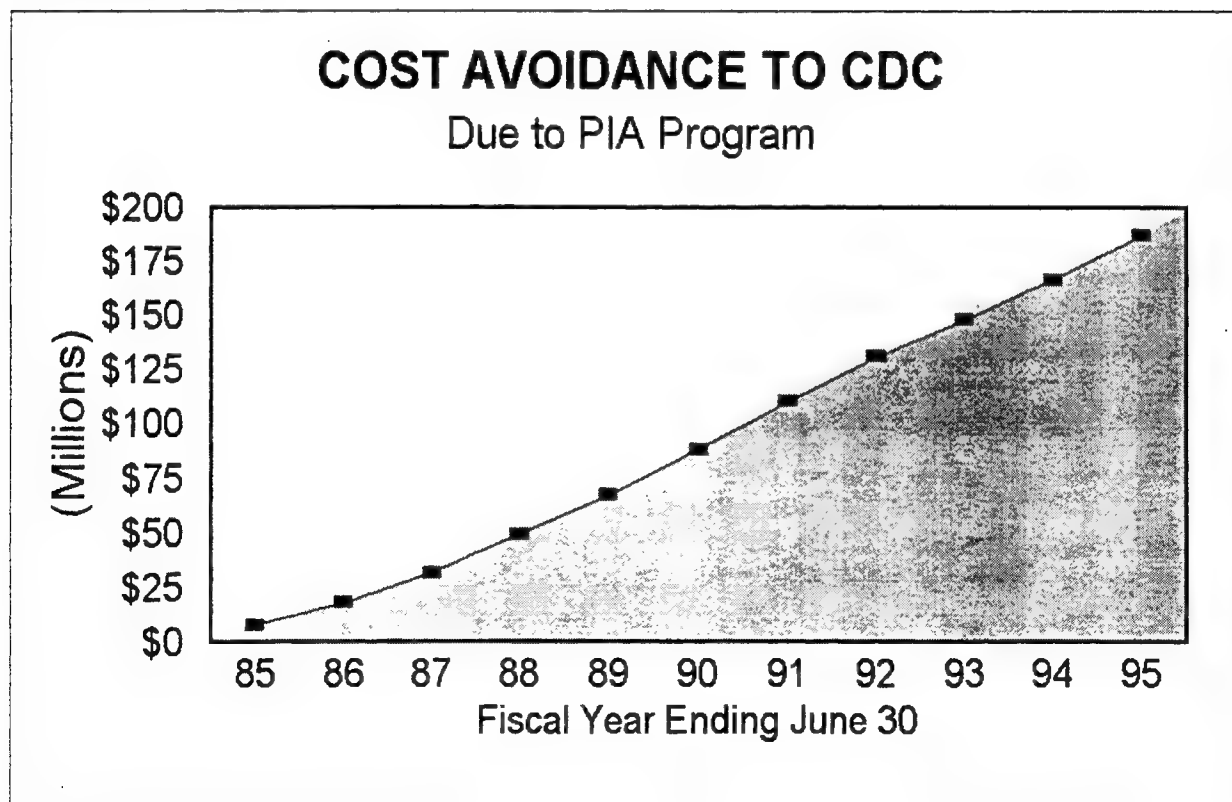


Figure 6

Despite its own continued insistence on quantifiable data, the audit report discounts PIA's cost avoidance contribution to CDC based on a public policy preference, not on hard facts. While discussing the policy merits might be appropriate, it does not reduce the reality of \$187 million in quantifiable costs avoided. The audit cites a recently released report by CDC on the savings realized as a result of the Three Strikes legislation, as a basis for questioning the sentence reduction credits as a cost avoidance. Yet the savings in CDC's Three Strikes report encompassed the benefit of sentence reductions for programming in its overall calculations. The figures include the premise that the State is benefitting from sentence reduction credits.

In addition to these quantifiable benefits, the employment of inmates is of significant benefit in the area of prison management. Prison administrators use a hierarchy of "rewards" to manage the inmates, and PIA jobs are among the top. The sentence reduction credits earned provides an added incentive for inmates to maintain good behavior, since loss of a PIA job means loss of credits and no pay. Inmate employment through PIA is a necessary and powerful instrument to help manage the escalating prison population.

CDC is not aware of any correctional system in the United States that has as many idle inmates who are eligible for work assignments as California. Coupled with a population approaching 200 percent of design bed capacity, which is also the highest in the U.S., this idleness contributes to tension and anxiety. Prisoners with excessive amounts of idle time continue to pose behavior problems for prison management. The assault rate between inmates has increased 25 percent since 1990; the assault rate on prison staff has increased almost 50 percent during that same period. **CDC estimates that the thousands of idle, but eligible inmates increased incarceration costs by \$49 million each of the past three years.**

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The alternative to inmate idleness is funding for additional programming. The audit report disagrees with PIA's position that its 7,000 employed inmates would probably be programmed into vocational education if they were not working for PIA. Rather, they suggest that in lieu of vocational education programming, which has higher costs, CDC could choose to program more of the inmates into institutional support, the lowest cost alternative. There is a limit to the number of inmates that can be assigned to institutional support. With over 15,000 eligible inmates on the waiting list, CDC finds the current idleness levels intolerable. A budget change proposal is moving through the system to add \$7.1 million annually to CDC's budget to provide work assignments for 3,145 inmates in a combination of academic, vocational education, and institutional support activities. This proposal, which includes a combination of all alternative programming options to PIA jobs, costs \$2,250 per year per inmate assignment.

To reprogram all of PIA's 7,000 inmates into other alternatives, per the mix proposed in CDC's budget proposal, would cost taxpayers an additional \$15.7 million annually. Were PIA not employing over 7,000 inmates, CDC would not accept an almost 50 percent increase to its waiting list and watch the assault rates climb. Some alternative programming would be provided, at significant additional costs to taxpayers.

Chapter 2

THE PRISON INDUSTRY AUTHORITY IS UNABLE TO MANAGE COSTS AND PROFITABILITY OF ITS PRODUCTS AND FACTORIES

PIA fully recognizes the importance of the cost accounting issues raised in the BSA report. PIA is impressed with the level of detail provided, including the use of activity based costing, which is very resource intensive. Recent management reports received from PIA's own independent auditors have focused on many of the same issues contained in this report.

The multi-year effort to install PIA's Manufacturing Accounting and Planning System (MAPS) is testimony to PIA's commitment to accurate, timely financial and management reports and product cost detail. The implementation of MAPS required a tremendous investment of time and money, the dividends of which are already apparent. PIA concurs with many of the comments in Chapter 2. PIA has not progressed as quickly as it would like in this area; this is more a reflection of the competing demands for PIA's resources than the lack of recognition of the importance of cost information. Application of cost accounting principles in PIA is all the more complex because of PIA's decentralized nature and diversity of enterprises.

Chapter 3

PIA INVENTORY LEVELS ARE EXCESSIVE

The BSA states in Chapter I, Page 8, of its report that *"Because the PIA operates a penal program directed by legislative mandate, we believe it is unfair to compare the PIA's profitability and rate of return with private sector companies"*. They chose, however, to compare PIA to private industry when reporting on PIA's inventory levels.

Comparing PIA's inventory level to other prison industry programs is the correct measure because the environment in which they operate most closely approximates PIA's. As can be seen in the chart on Page E-6, Appendix E, *"Comparison of Correctional Industries in Selected States and Federal Government"*, PIA's number of days of inventory on hand falls in the middle of the range.

PIA's inventory levels are negatively affected by several factors in addition to environment. First, PIA often spends several months in the spring of the year manufacturing products for one or more large orders from State University customers. These customers often request delivery during July/August inflating inventory levels at the end of June which was the date used in the BSA calculations. For example, PIA was building inventory for delivery of approximately \$1 million in product for CSU Monterey Bay for delivery in July and August 1995.

Second, every year, PIA receives an influx of orders from State customers during May/June, as they use the remaining balance of their budgets. This influx carries over into July/August as customers order from their new fiscal year appropriations. This consistent ordering pattern results in PIA having increasing inventory levels as of June 30 of any year. This cyclical pattern was not considered in the analysis, although PIA did bring it to the BSA's attention.

Third, PIA must obtain its materials through a specific, lengthy State procurement process which is not found in private industry. As reported by BSA in Chapter 3, **this process can take up to nine months**. To minimize out-of-stock occurrences, PIA must carry inventory levels higher than would be found in the private sector. However, PIA does agree that some identified inventory levels were high and will be exploring methods for reducing them.

Of concern to PIA in this finding is that while the audit report acknowledges the serious contributing factors of the State procurement system to the problem, it makes no recommendations to relieve PIA of the burden of the State's procurement rules so PIA can operate more efficiently. Quite the contrary, BSA's reorganization options include moving PIA into a more government-like model subsumed by the larger bureaucracy of CDC.

THE AVERAGE PIA PRODUCT DELIVERY TIME IS UNACCEPTABLE

Customer analysis based on prior PIA surveys revealed that the single most significant action to change PIA's negative image and demonstrate its commitment to meet customer needs, is the prompt delivery of office furniture. The subsequent customer survey conducted by BSA identified past delivery performance as the major source of customer dissatisfaction. This same survey reported that customers are **extremely satisfied** with the Prompt Delivery Program. The auditors noted in Chapter III that *"In response to these concerns (customers), the PIA introduced the Prompt Delivery Program in the Fall of 1995, and has significantly reduced delivery times on the furniture available through this program"*. They further stated, *"The response by customers to the short delivery times has been overwhelming. Many customers responding to the survey conducted by this performance audit specifically noted that they were extremely satisfied with the Prompt Delivery Program"* (Underline added).

THE PIA HAS TOO MANY PRODUCTS

The audit correctly cites that PIA has too many products. PIA is aware that its large product line results in problems not generally encountered in businesses in the private sector. In fact, PIA has identified narrowing the product focus as one of its management strategies. However, this strategy will not result in a structure that is suggested in the audit report, *"... a manufacturer will operate in only those industries it knows well."* The State Auditor attributes PIA's diversity to one factor, the *"....attempt to provide employment for a rapidly increasing prison population."* The State Auditor has overlooked that

PIA's statutes create his situation. PIA is statutorily mandated under Penal Code Section 2808(h) *"to establish industrial, agricultural and service enterprises, to provide as much employment for inmates as is feasible, and to provide diversified work activities to minimize the impact on existing private industry in the state."* (Underline added).

At the same time, the Prison Industry Board (PIB) is charged with the responsibility to hold public hearings and to **disapprove** the establishment of any new enterprise **or expansion of an existing enterprise** if it determines that the enterprise would *"have a comprehensive and substantial adverse impact on California industry which cannot be mitigated"* (Penal Code 2808(l)). The combined impact of these two legal provisions preclude PIA from developing a few large enterprises. Diversity into other enterprises is the only alternative.

Moreover, the Penal Code restricts PIA's customer base to State agencies and local government which results in a very limited demand for any one product. In order to increase sales and inmate employment, PIA must provide diverse product lines. PIA's market base is too small to limit production to only a handful of products.

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CUSTOMERS ARE NOT SATISFIED WITH PIA PERFORMANCE

PIA is acutely aware of the concerns of its customers and is making substantial progress in addressing these issues. As the audit notes, PIA has achieved dramatic improvement in deliveries via its Prompt Delivery Program and has implemented major organizational strategies to improve the competitiveness of product pricing and to refine its product line.

In addition to these initiatives, PIA has made significant efforts to enhance the overall focus on its customers. In late 1992, PIA reorganized and established a marketing division to ensure that it had a customer advocate at the executive management level. In November of 1993, it implemented a Five-Year Business Planning process that defined management's **vision of PIA as a highly respected, profitable, customer-focused team**, and included the goals and strategies necessary to achieve this vision.

A priority effort in 1994 was directed at improving responsiveness and customer service. This included a major realignment of PIA's Sales and Customer Services teams based on recommendations developed by CSU-Chico. Their analysis of PIA's business process included not only input from PIA staff, but also the conduct of customer forums involving major PIA customers. The results of this are evident in the **consistently favorable ratings PIA received in Customer Services on the audit survey**.

Survey respondents also reacted favorably to PIA quality, a reflection of PIA's ongoing organizational emphasis on Total Quality Management as its business process. PIA is concentrating more attention on the quality expectations of customers and on the quality goals and standards being embraced by private businesses. In addition to ongoing organization-wide training, PIA has implemented several specific quality projects, three of

which (coffee roasting, laundry, and implementation of a PIA wide Quality Advisor Team) were presented at the Sacramento Area Council Total Quality Conference in April 1994.

PIA has also imposed outside testing requirements to ensure products meet or exceed competitive standards in a variety of areas, including structural integrity for seating, fire retardency for upholstery fabrics and mattresses, and Underwriters Laboratory listing for panel systems. As a result, by the close of the fiscal year, PIA expects to be leading the market in seating quality by offering only chairs which meet the seating standards of the American National Standards Institute/Business and Institutional Furniture Manufacturers Association, even though this is not currently a State agency purchasing requirement.

In addition, in this fiscal year, PIA is redesigning its waiver process to make it more responsive to customer needs, and has implemented a new complaint tracking system through MAPS. The latter will enable PIA to monitor product quality problems by product and type in order to take more immediate corrective action. PIA believes the survey results provided by the audit will be a valuable tool in assessing PIA's progress in improving its customer focus.

THE PIA SHOULD IMPROVE ITS CASH MANAGEMENT

The audit report suggests that in July 1993, PIA should have paid off \$15 million in debts to reduce future interest costs. Further, the audit suggests that PIA's policy of maintaining a cash level equal to two months operating costs is unnecessary. This reasoning is consistent with private industry practices, but not in PIA's operating context.

PIA's two month cash policy was developed with the assistance of the audit firm of Coopers and Lybrand. The conclusion was that private industry practices for cash management are not appropriate for PIA. PIA cannot react swiftly to downturns in its statutory market; State laws prevent it from using typical private sector responses, such as immediate layoffs. PIA's limited market requires consideration of the budgetary constraints imposed on its customers as part of the cash management strategy

The audit report further states that PIA is assured of an ongoing cash flow. That is true only if a State budget is in place. In July 1992, there was no State budget for two months. The resulting backlog at the State Controllers Office required PIA to operate without full receipts from State agencies for five months. Based on this experience, action just seven months later to wipe out half of its total cash for long term debt reduction purposes, would not have been in PIA's best interests. Over the last two fiscal years, PIA managed its cash levels and reduced its debt by paying off \$10 million of its outstanding loans as part of the overall cash management strategy. This has achieved the goal of reducing long term debt costs without jeopardizing monthly cash flow. PIA believes this approach is most appropriate for a government entity.

Responsible financial management in the public sector has additional and very different considerations from the private sector. Clearly, the auditors are using a private industry perspective as is evidenced by the recommendation in the report that **if PIA experiences cash flow problems, it should seek a line of credit from a private bank**. When consulted on this issue, the Government Finance Officers Association responded that while this is a very common practice in private business, it is not aware of any State agency in the nation that has a separate “line of credit”. Ultimately, this approach would only increase PIA’s debt load and costs which is not good public policy.

Chapter 4

PIA appreciates the audit’s acknowledgement of accomplishments.

Chapter 5

THE PIA HAS EVER CHANGING INTERNAL MISSION STATEMENTS

The audit report contends that the numerous (four) changes to PIA’s mission statements over the last ten years have contributed to the organization’s inability to set clear, measurable priorities.

The report does acknowledge that, “*..the PIA has tremendous external legislative and economic pressures from both changing legislative priorities and more demanding State customers*”; however, it fails to address several pertinent points:

First, all of the mission statements are reflective of statutory goals which have essentially remained unchanged since their inception in 1983. **Each mission statement has consistently addressed the legislative intent to employ inmates in an efficient, businesslike manner and to maintain self sufficiency.** What has varied is the emphasis placed upon these goals which is driven by the legislative and economic climate of the State; periodically adjusting the balance between these goals is both necessary and appropriate.

Second, the report fails to put these changes in organizational focus into the proper perspective. Shortly after this growth period referenced in the report, CDC went through a period of prison construction that was unprecedented in the world. The number of PIA enterprises increased by 98 percent, and inmate employment rose by 122 percent. Shortly after this growth period, the State’s economy had the biggest downturn since the depression. PIA would have been remiss had they not responded to these changes in the political and economic landscape of California through a reformation of the organizational goals.

Third, the audit does not truly acknowledge the more subtle changes that have taken place in the marketplace and customers' expectations. Customers are more demanding with respect to quality, service, price, and delivery. Shrinking State budgets have also accelerated the need to squeeze more out of available dollars. PIA has recognized these demands through a renewed focus on the customer and by embracing the Total Quality Management philosophy and the implementation of the Prompt Delivery Program and MAPS.

THE PRISON INDUSTRY BOARD DOES NOT EFFECTIVELY MONITOR THE PIA OPERATIONS

The audit states that *"The Prison Industry Board is not independent, provides insufficient input to PIA policy, and does not effectively monitor PIA operations. Most importantly, the Board performs a weak budgetary review of PIA."* Furthermore, the audit claims that PIB does not represent the general public, organized labor, and private industry in the fashion intended by the Legislature.

PIA finds these claims to be quite serious in light of the fact that the audit team had no objective criteria for evaluating PIB's performance. Furthermore, there was little empirical basis for these allegations.

Of particular concern is the claim that PIB plays a weak role in representing the interests of labor and private industry. The audit team failed to include in the report the significant role played by PIB in the public hearing process to assess and mitigate any adverse impact on California business. Between January 1983 when the enabling legislation was effective and June 1995, PIB conducted approximately over 100 public hearings to appraise the effect of PIA expansion on the private sector. The PIB ruled in favor of private industry in 16 of these hearings. **The only reference in the audit to this critical role of PIB was a cursory reference in an exhibit.**

Contrary to audit statements, PIB has played an integral part in policy direction and the implementation of programs critical to the growth of PIA. The audit report failed to acknowledge PIB's role in the following areas:

- ▶ The PIB was the motivating force behind the implementation of MAPS. The audit team was complimentary of PIA's manufacturing information system yet did not explore the proactive role played by PIB in the implementation.
- ▶ The PIB was instrumental in expanding the Civil Rights and Community Affairs Office.
- ▶ The PIB provided the impetus and the direction for the aggressive litigation prevention program implemented in 1994. As a result of these efforts, PIA's litigation costs continue to drop.

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- ▶ The PIB played an active role in the development of PIA's Waste Management Program.
- ▶ The PIB was the impetus behind the recent enterprise expansion program.

Finally, the claim that little budgetary review is performed is totally without foundation. In addition to a review by the full PIB, the Annual Plan is subject to a thorough review by the Finance Committee, the Vice Chairman, and the Chairman himself. Between the internal reviews and PIB's analysis, the budget is subject to a review comparable to many State programs.

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It would appear that in its haste to criticize PIB's efforts and their administrative relationship with PIA, the audit team completely failed to evaluate the performance of PIB in a thorough and professional manner. The fact that the team neglected to interview either the Executive Officer or the Chairman of PIB relative to the PIB's performance or oversight of PIA, is a further indication that the auditors have made conclusions without supporting data or objectivity.

3

Chapter 6

RECOMMENDATION: THE LEGISLATURE SHOULD CLARIFY THE STATUTES GOVERNING PIA

Clearly defined legislative priorities would indeed be of benefit to PIA. However, they would need to be internally consistent; taken as a whole, the audit recommendations are not. PIA needs to either price at cost and operate as a State program, or let competitive market pricing drive its efficiencies, as do most businesses. That the audit recommends PIA do both again reflects an inability to resolve the basic dilemma of PIA as a program or a business.

PIA will not accomplish an improved competitive stance if it is required to adopt a cost-of-service (i.e., State agency) model that allows it no ability to capitalize on competitive strengths (as do most businesses) to support some lesser efficiencies. This is particularly true if PIA product costs must include what the audit believes are "subsidies" (as discussed at length elsewhere). If the costs of the additional program audits and performance measures are also imposed as recommended, then PIA will have very little chance of competing with private businesses. Again, the application of additional program responsibility is not consistent with the audit expectation that PIA should compete with private industry on a price competitive basis.

RECOMMENDATION: THE LEGISLATURE SHOULD EITHER MAKE THE PIA A DIVISION OF THE CDC OR REFORM THE PRISON INDUSTRY BOARD

The recommendation instructs that the "*Legislature should establish clear accountability for PIA's performance with either the PIA's General Manager, the Director of CDC, or the board.*" While the State Auditor offers specific structural and operational suggestions for improving the effectiveness of PIB, no rationale is offered to explain how PIA's effectiveness would be enhanced by eliminating PIB and/or making PIA a division of CDC.

Ironically, by suggesting that PIA become a division of CDC, the State Auditor is actually proposing a course which was consciously abandoned by the State Legislature in 1982. The PIA was established on January 1, 1983 as the successor to the California Correctional Industries. The historical and statutory notes to PIA's enabling legislation (Chapter 1549/82) provide clear insight as to why PIA was instituted in its current form:

- (b) *The constraints of state government severely impede the ability of the prison industries program to operate on a self-supporting or profit-making basis.*
(Underline added)
- (c) *A successful prison industries program can best be accomplished by providing the management of the prison industries program with a reasonable degree of autonomy and by establishing a special authority to manage and operate prison industries and the funds associated with such programs.* Underline added)

In brief, 13 years ago, the Legislature recognized the inherent uniqueness of PIA's program. Yet the State Auditor does not explain how a return to the basic model under which PIA previously operated would improve PIA's operation. Moreover, the State Auditor did not probe the very circumstances which initially caused the Legislature to form the current PIA.

In conclusion, PIA believes that any discussion of PIA's organization that does not consider the effects on PIA's ability to compete effectively in the market place is incomplete.

RECOMMENDATION: BOTH THE CALIFORNIA DEPARTMENT OF CORRECTIONS AND THE PIA SHOULD DEVELOP THE PENAL ASPECTS OF THE PIA PROGRAM

CDC is already engaged in the development of a fully automated Correctional Management Information System (CMIS), the principal purpose of which is to efficiently track inmate population data. CDC believes that it can incorporate into CMIS, data relating to an inmate's PIA work history and post-release work history.

Notwithstanding the above, the overall issue of "penal development" as it relates to PIA must be addressed in conjunction with the State Auditor's initial recommendation:

"The Legislature should clarify the statutes governing PIA."

Currently, neither CDC nor PIA measures the role of PIA in terms of correctional outcomes because there is no clear mandate in statute to do so. The manner in which the issue of statutory priorities is clarified will be the single most important factor in resolving the ultimate breadth and scope of this endeavor.

RECOMMENDATION: PIA SHOULD ESTABLISH POLICIES AND PRACTICES TO ENSURE COST EFFICIENCIES AND IMPROVE THE MANAGEMENT OF ITS OPERATIONS

PIA recognizes that there is ample room for increased efficiencies and improvements in its operations. We, therefore, especially appreciate the recommendations of the BSA in these areas. PIA is committed to studying the potential costs and benefits of implementing each recommendation of BSA. In the short term, however, PIA envisions giving highest priority towards addressing the following specific recommendations:

- ▶ reviewing and updating labor and raw material standards used for each product focusing on direct labor hours;
- ▶ evaluating and resolving significant variances between each product's standard costs and actual costs;
- ▶ reducing from six weeks to three weeks the time required to prepare and deliver month-end financial management reports;
- ▶ improving utilization of MAPS;
- ▶ improving short-term forecast of customer needs;
- ▶ performing a comprehensive review of all PIA industries and products to determine which should be expanded, scaled back, or eliminated.
- ▶ surveying customer satisfaction regularly;
- ▶ reducing average delivery times;
- ▶ ordering the raw materials more frequently in smaller amounts and increasing the number of raw materials purchased under statewide contract;
- ▶ and providing each warehouse Manager with written policies and procedures regarding inventory levels and matters related to effective materials management.

RECOMMENDATION: CDC SHOULD IMPROVE ITS OPERATIONS WHICH IMPACT PIA

The CDC agrees that improved forecasting and managing of its inmate clothing requirements would mutually benefit CDC and PIA.

In fact, CDC is developing the Corrections Automated Materials Management System (CAMMS). The CAMMS is a response to a highly cumbersome, decentralized procurement process which currently exists at CDC. The mission of CAMMS is to secure tangible savings in both materials cost and staff cost through department wide standardization and consolidation of materials management activities.

The realm of clothing procurement is being specifically addressed in another database which CDC is also developing, the Correctional Management Information System (CMIS). Under CMIS, when an inmate is processed through a reception center, his/her weight, height, clothing size factors, and shoe size will be recorded. This data will be maintained as an attribute of each offender in the CMIS database for ongoing use.

Thus, CDC believes it is building the infrastructure which will facilitate the implementation of the State Auditor's recommendation. In this context, CDC will work alongside PIA to implement this recommendation to the maximum extent possible.

To provide clarity and perspective, we are commenting on responses to our report from Chairman of the Prison Industry Board (PIB) and the Prison Industry Authority (PIA). Our comments on the chairman's and the PIA's specific concerns are numbered to correspond to those we have placed in their response provided in Appendix G of this report.

1. The PIB apparently believes that because the PIA operates in a government setting, it cannot operate in a businesslike manner and therefore, should not be compared to private enterprise. We disagree. While we acknowledge that there are many differences between the PIA and private enterprise operating environments, we believe there is a great deal the PIA could learn by benchmarking itself against private enterprise. In addition, all of our comparisons of the PIA to private enterprise were fairly conservative in that we utilized median industry results or practices, not the best practices or results. Finally, we included comparisons to other state's prison industries to provide balance and perspective for the reader. We do not believe that the results of other state's prison industries should be the only measure of the PIA's success. In fact, a number of state auditors in other states are in the midst of conducting reviews of prison industries using similar criteria.
2. The PIB apparently does not understand Generally Accepted Accounting Principles (GAAP). GAAP would not prevent the PIA from reporting all costs of the program, although the PIA chooses to report only their direct costs. Also, the concept of "self-sufficiency" is not addressed by GAAP. However, the Penal Code does address this issue. Specifically, Section 2801(c) states that one of the purposes of the PIA is to operate a work program for prisoners that will ultimately be self-supporting by generating sufficient funds to pay all of the expenses of the program. The PIB would prefer to ignore costs of supporting the PIA which are not paid directly by the PIA. However, we examined the PIA from the perspective of determining how PIA's activities affect the taxpayer. The question of whether the PIA, or some other component of state government, paid to support the PIA's activities is not important. In the final analysis, all of the money comes out of the taxpayers' pockets. Therefore, we believe that any analysis of the issue of PIA's self-sufficiency must include all funds provided by the taxpayers to support the PIA, not just those included on the PIA's financial statements.
3. The PIB needs to recognize that the PIA must change along with the rest of California state government in becoming more competitive and cost-effective. Governor Wilson has directed all state agencies and departments to "fundamentally rethink the structure and performance of state government from the bottom up."

4. The PIB is incorrect. We met with the chairman of the PIB on three different occasions, and he had ample opportunity to provide our audit team with his input. Also, we interviewed three other present and past members of the PIB at length. In addition, we tried to interview the chair of the PIB Finance Subcommittee who has been on the PIB since its inception. He declined to be interviewed for this management review stating "I have nothing new to contribute." Finally, despite numerous attempts, another long time PIB member did not return our telephone calls.
5. We take exception to the PIB's characterization of the "cavalier" attitude of the audit team. During two of our three meetings with the chairman, we discussed our concerns and recommendations regarding the PIB. We took his concerns and comments seriously, and adjusted our report where appropriate.
6. The PIB is incorrect. The audit team never, at any point during the review, dismissed the value of the PIA in reducing inmate idleness. We explicitly recognize that the PIA is a penal program and that there is potential penal value to employing inmates. In fact, we justify leaving the PIA's monopoly over state agencies intact so that it can continue providing this value.
7. We are pleased that the CDC and the PIA now recognize the importance of quantifiable data and that the PIA will be working with the CDC to develop the necessary data systems.
8. We do not "acknowledge" that PIA's inmate employment over the past ten years has saved the State over \$187 million in costs to program and house inmates. As noted in the report, we are simply repeating an estimate the PIA prepared in response to this audit. We do not opine on the accuracy or validity of the PIA's estimate.
9. The PIA is not self-supporting when the significant subsidies of interest and rent are included. The Penal Code states that one of the purposes of the PIA is to operate a work program for prisoners which will ultimately be self-supporting by generating sufficient funds to pay all of the expenses of the program. The Penal Code does not limit the expenses of the program to only those paid directly by the PIA. We examined the PIA from the perspective of determining how the PIA's activities affect the taxpayer. The question of whether the PIA or some other component of state government paid to support the PIA's activities, is not important. In the final analysis, all of the money comes out of the taxpayers' pockets. Therefore, we believe that any analysis of the issue of PIA's self-sufficiency must include all funds provided by the taxpayers to support the PIA, not just those included on the PIA's financial statements.
10. We are concerned with hidden subsidies, as are other states who are planning or are already conducting similar performance audits. The fact that other correctional industry programs do not pay interest on contributed capital is irrelevant. Likewise,

the fact that PIA is not aware of any other program funded by general obligation bonds which report such interest on their financial statements is also irrelevant.

11. The PIA's analysis of cost avoidance ignores the impact of rent and price subsidies we identified in the report. We estimate the rent subsidy to be \$4.8 million for fiscal year 1994/95. We also estimate that state agencies subsidized PIA's activities by paying the PIA \$12 million more than low market price for goods and services during fiscal year 1994/95. These subsidies, combined with the interest subsidy estimated at \$5.4 million for fiscal year 1994/95, eclipse the \$19 million in annual "cost avoidance" claimed by the PIA.
12. The PIA has characterized the estimated sentence reduction benefits as cost avoidance to California taxpayers. As we mentioned in the report, the PIA has not considered the potential costs to the taxpayers of releasing inmates early. In addition, the PIA's analysis ignores the CDC's own report on the benefits to taxpayers of keeping inmates in prison rather than releasing them early.
13. The PIA's graph of cost avoidance is misleading. This graph displays the PIA's estimate of cumulative cost avoidance over a ten-year period. A reader might interpret the graph to mean that the PIA estimates over \$175 million in costs were avoided in fiscal year 1994/95 as a result of PIA. In fact, the PIA estimates \$21 million in cost avoidance in fiscal year 1994/95.
14. The PIA is incorrect. Our comparative prices do include delivery charges.
15. We are pleased to see that the PIA agrees with the overall need to continue improving management process and controls. This critical finding is a major focus of our report's operational recommendations.
16. While we acknowledge that there are many differences between the PIA and private enterprise operating environments, we believe there is a great deal the PIA could learn by benchmarking itself against private enterprise. All of our comparisons of the PIA to private enterprise are fairly conservative in that we utilized median industry results or practices, not the best practices or results. The PIA also has a large number of advantages over private enterprise, as we point out in the introduction to the report. The PIA consistently chooses to focus on their disadvantages rather than capitalizing on their numerous competitive advantages over the private sector. Finally, we strongly disagree with the PIA's contention that their inability to compare favorably with average private enterprise results is a measure of how constrained PIA is as a state program.
17. The PIA is incorrect. We do not say in the final report that PIA free staff has increased. We notified the PIA of this change from an earlier draft report prior to the PIA issuing their formal response.

18. The PIA's graph of PIA employment is misleading. The graph inappropriately combines two different scales on the vertical axis. The two comparative line graphs do not belong together and mislead the reader as to the magnitude of changes in PIA employment.
19. The PIA is incorrect. We use actual personnel years provided by the State Controller's Office for fiscal year 1989/90 and 1994/95. We notified the PIA of this change from an earlier draft report prior to the PIA issuing their formal response.
20. Notwithstanding the legislative intent, we include the \$54 million in interest costs to more fairly and accurately depict the true costs of the PIA's program. Regardless of whether the General Fund or the PIA pays the bill, interest on money borrowed to build PIA facilities and purchase PIA equipment is still a cost of the program.
21. The fact that correctional industries in other states do not directly pay their share of the debt service costs on general obligation bonds is irrelevant.
22. Our "model" for including unrecognized subsidies in our analysis of the PIA's self-sufficiency is not based upon the private sector as the PIA alleges. Rather, it is based upon a common-sense approach to determining what impact the activities of the PIA have on the taxpayer.
23. The PIA is incorrect and does not understand finance. The \$21 million is expressed in 1994/95 dollars and already includes all accumulated interest earnings over time; therefore, the comparison that we make is appropriate.
24. The PIA misses the point. Because the PIA operates as a monopoly, it is unfair that some customers must pay higher prices to subsidize inefficient activities that benefit other customers.
25. The PIA is incorrect when it states that PIA prices are not consistently higher than those of the private sector. As we discuss in the report, the PIA's customers paid approximately \$12 million more than low market prices during fiscal year 1994/95.
26. We conducted this analysis in an effort to validate the claim often repeated by the PIA and CDC that the PIA actually reduces the costs of operating a prison. Because neither the PIA nor the CDC could provide any quantifiable evidence of such an effect, we tested their hypothesis. Although information we used from all CDC prisons show that security and education personnel costs are actually higher in those prisons with PIA, we acknowledge there are a number of factors that could skew these results and, therefore, we do not make that conclusion. Nevertheless, in the absence of any other evidence or data, we do feel comfortable with our conclusion that the PIA does not appear to reduce the costs of operating a prison. Rather than developing their own data and analysis to support their claim, the PIA attempts to discredit our analysis.

27. The CDC is inconsistent in its conclusions regarding whether there are benefits from sentence reduction yet claims that our conclusion defies logic. In a report by the CDC on the economics of the "three strikes" law, the CDC contradicts its position regarding the value of sentence reduction programs when it states that it saves taxpayers money by keeping felons in prison instead of releasing them.
28. The PIA's graph is misleading. This graph displays the PIA's estimate of cumulative cost avoidance over a ten-year period. A reader might interpret the graph to mean that the PIA estimates over \$175 million in costs were avoided in fiscal year 1994/95 as a result of PIA. In fact, the PIA estimates \$21 million in cost avoidance in fiscal year 1994/95.
29. This is the first time the PIA presented this estimate of idle inmate costs. Again, neither the PIA nor the CDC provide support or explanation of any kind for this estimate.
30. The PIA claims that because the State's procurement process is so lengthy, it must carry higher levels of inventory than would be found in the private sector. We disagree. The fact that the PIA knows that the procurement process is lengthy simply means that they need to do a better job of planning and anticipating their needs. Instead, the PIA chooses to take the easier and more expensive alternative of stockpiling inventory.
31. We are confused by PIA's comments on this subject. The PIA starts out earlier in its response letter by acknowledging that it has too many products and has identified narrowing its product focus as one of its management strategies. The PIA then goes on to explain why it must have such a diverse product line. This type of contradictory logic may indicate that PIA staff and/or the management do not really embrace their new strategy of narrowing their product line.
32. The PIA is incorrect and is attributing findings to us that we do not make in the report. Nowhere in our report do we make any claim that the "PIB plays a weak role in representing the interests of labor and private industry."
33. We found no evidence that the Prison Industry Board performs a thorough review of PIA's annual budget. The Legislative Analyst's Office is in the midst of a review of PIA, including the PIA's budgetary review process; it expects to issue a report on this subject within the next month or so.

cc: Members of the Legislature
Office of the Lieutenant Governor
Attorney General
State Controller
Legislative Analyst
Assembly Office of Research
Senate Office of Research
Assembly Majority/Minority Consultants
Senate Majority/Minority Consultants
Capitol Press Corps